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Supreme Court, U.S.
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In the Supreme Court
OF THE
United States

OCTOBER TERM 1988

EATON CORPORATION,
Petitioner,

VS.

THE PKL COMPANIES, INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the Court of Appeal of California,
Second Appellate District

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QUESTIONS PRESENTED

Eaton Corporation ("Eaton") respectfully petitions for a writ of certiorari to review the judgment of the Court of Appeal of California, Second Appellate District, in this case. Eaton challenges the constitutionality of a $15,000,000 punitive damages award rendered by a jury that was given unfettered discretion to impose punishment in whatever amount it deemed appropriate, and which was imposed against Eaton, the innocent successor to the party accused of wrongdoing.

The following questions are presented:

1. Whether the Excessive Fines Clause of the Eighth Amendment applies to civil actions and, if so, whether it prohibits a punitive damages award of $15,000,000, constituting 10% of the wrongdoer's net worth and 62% of its net income.

2. Whether the Due Process Clause of the Fourteenth Amendment prohibits a punitive damages award of $15,000,000 where the jury has unrestrained discretion to punish in any amount and no state law defines the maximum amount or sets standards under which such damages may be imposed.

3. Whether the Due Process Clause of the Fourteenth Amendment prohibits imposition of a punitive damages fine of $15,000,000 against a totally innocent corporate successor for the conduct of a predecessor which has completely ceased to exist.[1]

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[1]Eaton has no parent company. In compliance with Rule 28.1, a complete list of all non-wholly owned subsidiaries and affiliates is contained in Appendix H. The only parties to this action are shown in the caption.

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PETITION FOR WRIT OF CERTIORARI

To the Court of Appeal of California,
Second Appellate District

Petitioner Eaton Corporation ("Eaton") respectfully prays that a writ of certiorari issue to the California Court of Appeal, Second Appellate District.

In only the last five months, the California Supreme Court in two commercial cases has let stand jury awards of punitive damages totalling $29,000,000.[2] In affirming the unprecedented $15,000,000 punitive damages award

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[2]The California Supreme Court's refusal to act in this case followed less than three months after its denial of the Petition for Review in the *April Enterprises v. KTTV* matter, wherein the petitioner challenged the constitutionality of a $14,000,000 punitive damages award under the federal Due Process and Excessive Fines Clauses (also now before this Court on a Petition for Writ of Certiorari, *Metromedia, Inc. v. April Enterprises, Inc.*, Docket No. 88-625, filed October 14, 1988).

in this case, the state high court again permitted the imposition of such damages by juries having unfettered discretion to decide punishment, despite arguments by Eaton that such damages violate the Due Process Clause of the Fourteenth Amendment and the Excessive Fines Clause of the Eighth Amendment. This, even though such maximal punishment was levied against a party totally innocent of any wrongdoing. The California court, by refusing to disturb the award, sanctioned the extension of California law to permit the imposition of punishment damages on a successor party sharing no identity of interest with the predecessor party who allegedly committed wrongdoing. As suggested by the recent grant of certiorari in *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*, No. 88-556, this Court's intervention is appropriate to bring constitutional fairness to the imposition of punitive damages fines, an issue with far-reaching significance for litigants in every court of the nation.

OPINIONS AND ORDERS BELOW

The opinion of the California Court of Appeal of July 18, 1988 was ordered by that court to remain "unpublished" and is reproduced in Appendix A, A-1 to A-56. The order of the Court of Appeal dated August 16, 1988 denying Eaton's Petition for Rehearing is also unreported and is reproduced in Appendix C. The order of the California Supreme Court dated November 16, 1988 denying Eaton's Petition for Review is unreported and is reproduced in Appendix D.[3]

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[3]Citations to the various Appendices throughout this petition will be designated as "App," with pertinent appendix page numbers. The Court of Appeal issued an order modifying its opinion to correct a typographical error, and this order is reproduced in Appendix B.

JURISDICTION

This Petition is filed within ninety days of the denial of the Petition for Review by the California Supreme Court on November 16, 1988. In denying review, the state high court refused to pass upon Eaton's argument that this Court's decision in *Banker's Life and Casualty Co. v. Crenshaw,* 108 S.Ct. 1645 (1988) instructed state courts of last resort to consider whether the Due Process Clause and Excessive Fines Clause rendered punitive damages awards such as that imposed in this case unconstitutional. As discussed in more detail below, the federal constitutional questions presented in this Petition were properly raised in the state court. This Court has jurisdiction under 28 U.S.C. § 1257(3).

CONSTITUTIONAL PROVISIONS INVOLVED

1. The Due Process Clause of the Fourteenth Amendment provides, in pertinent part:

> [N]or shall any State deprive any person of ... property, without due process of law.

2. The Excessive Fines Clause of the Eighth Amendment provides, in pertinent part:

> [N]or shall excessive fines [be] imposed.[4]

[4]In addition to these constitutional provisions, two California statutes are discussed below and were cited by the California Court of Appeal in affirming the punitive award against Eaton. The stautes are: California Civic Code Section 3294 (which authorizes punitive damages in non-contract cases) and California Corporation Code Section 1107 (which provides for the assumption of debts and liabilities by successor corporations). These statutes are set out in full in Appendix E. Title 28 United States Code Section 2403(b) may be applicable to this case.

STATEMENT OF THE CASE

A. Statement of Facts and Procedural History

Petitioner Eaton was not itself involved in the events giving rise to this lawsuit. Those events began in the mid-1970's. In 1975, Cutler-Hammer, Inc. ("Cutler-Hammer") became the majority shareholder of Macrodata Corporation ("Macrodata"). At that time, The PKL Companies, Inc. ("PKL") was a minority shareholder of Macrodata holding unregistered shares. PKL had the contractual right to request that Macrodata register the stock. In December 1976, PKL sued Macrodata and Cutler-Hammer alleging, *inter alia,* that Macrodata had failed to perform promises to register PKL's stock and that Cutler-Hammer had breached its fiduciary duty as majority shareholder by taking action which had depressed the value of Macrodata stock. The Complaint sought damages for the alleged diminution of value of PKL's stock.

A year after the Complaint was filed, Macrodata was merged into Cutler-Hammer in strict compliance with the applicable provisions of the California Corporations Code (CAL. CORP. CODE §§ 1100-1112). In this transaction PKL tendered its Macrodata shares for Cutler-Hammer shares at the exchange rate established by an expert, and PKL thereby freely waived its statutory remedy (CAL. CORP. CODE §§ 1300-1312) of a speedy court-supervised appraisal of the value of its stock. Two years after the Complaint was filed, Petitioner Eaton acquired all Cutler-Hammer stock in a merger transaction which provided PKL with a $1,200,000 profit beyond the $327,000 cost of its original Macrodata investment. Cutler-Hammer thereafter ceased to exist as a separate operating entity.

Over Eaton's objections that PKL waived its exclusive remedy to challenge the value of Macrodata stock by declining court-supervised appraisal, the case went to trial before a jury in 1983 on two claims: promissory fraud and breach of fiduciary duty by majority shareholder. The jury returned a general verdict in favor of PKL, including the $15,000,000 punitive damages award.[5] According to the California Court of Appeal, PKL's evidence established that PKL relied on false promises of registration by Macrodata by failing to actively seek buyers for its stock and by delaying legal steps to compel registration of its shares until registration was no longer practical. The court also found that Cutler-Hammer took actions to acquire Macrodata stock at an unfairly low price, including pressuring Macrodata to understate its losses, failing to disclose other accounting errors to Macrodata's outside auditors, and concealing knowledge that Macrodata's financial statement was false until after it had been made public.

On the issue of damages, PKL's counsel stated in closing argument that "the real core of this case is the argument by PKL that Cutler-Hammer in 1977 paid an unfairly low price" when "[Cutler-Hammer] voted a merger based upon a value received by their friendly investment banker. . . ." The jury determined that PKL was entitled to compensatory damages of $2,633,599, measured by the "shortfall" represented by the difference

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[5]This was the second trial of the action. The case was first tried in February 1982. A verdict for PKL rendered in May 1982 was set aside by the trial judge on the grounds of lack of evidence and excessiveness of damages. In particular, the trial court ruled that a punitive damages award of $17,500,000 against Eaton was "clearly excessive."

between the value set for the merger and the value established six years later at trial.

Eaton appears in this case only as the successor-in-interest to Cutler-Hammer and Macrodata. Although Eaton never committed any wrong, the jury was instructed that it could award punitive damages against Eaton for the alleged wrongs of the non-existent Cutler-Hammer. App. F at F-1. As to the amount, the jury was given total discretion. App. F at F-2 to F-3.

The trial court's instruction, which followed the form approved by the Committee on Standard Jury Instructions of the Superior Court of Los Angeles County, was as follows:

> The law provides no fixed standards as to the amount of such punitive damages, but leaves the amount to the jury's sound discretion, exercised without passion or prejudice.
>
> [*Id.* at F-2.]

The jury was additionally instructed to "consider" the reprehensibility of the wrongdoer's conduct and the amount of punitive damages necessary to deter the wrongdoer in light of its financial condition, and was told that such damages "must bear a reasonable relation to the actual damages." *Id.* at F-3. The result was a staggering $15,000,000 punitive damages award, constituting 62% of Cutler-Hammer's 1977 net income and 10% of its net worth.

In post-trial motions, Eaton challenged the verdict on multiple grounds, including the exclusivity of the appraisal remedy, the excessiveness of the punitive damages award, and the unfairness of imposing such damages on an innocent successor. With respect to excessiveness, Eaton noted that the punitive damages award was totally

unprecedented in California, both in total amount and the ratio of the award to the wrongdoer's net income and net worth. Eaton further argued that there was no California precedent for the imposition of such punishment damages against a totally innocent successor corporation sharing no identity of interest with the predecessor who was the actual wrongdoer. As later pointed out by PKL in its brief before the state high court, any attack on the constitutionality of punitive damages on the grounds of due process, excessive fines or even the retroactive application of a new legal standard was foreclosed by binding California precedent. *Peterson v. Superior Court,* 31 Cal.3d 147, 161, 181 Cal.Rptr. 784, 792 (1982); *Egan v. Mutual of Omaha Insurance Company,* 24 Cal.3d 809, 819, 169 Cal.Rptr. 691, 695-696 (1979); *Bertero v. National General Corporation,* 13 Cal.3d 43, 66, 118 Cal.Rptr. 184, 201 (1975); *Downey Sav. & Loan Assoc. v. The Ohio Casualty Ins. Co.,* 189 Cal.App.3d 1073, 284 Cal.Rptr. 825 (1987), *cert. denied,* 108 S.Ct. 2023 (1988); *Grimshaw v. Ford Motor Co.,* 119 Cal.App.3d 757, 811, 174 Cal.Rptr. 348, 383 (1981); *Toole v. Richardson-Merrell Inc.,* 251 Cal.App.2d 689, 60 Cal.Rptr. 689 (1967). All of Eaton's post-trial motions were denied.

In the court of appeal, Eaton again challenged the excessiveness of the punitive damages award and the imposition of punishment damages on an innocent successor. Eaton's appeal was rejected by the court of appeal in an unpublished opinion dated July 18, 1988. App. A, A-1 to A-56. With respect to the amount of punitive damages, the court of appeal ruled that a punitive damages award will not be disturbed unless "so palpably excessive or grossly disproportionate as to raise a presumption [it] resulted from passion or prejudice" (App. A at A-53), and that this evaluation involves "a fluid process of adding or subtracting depending on the nature of the acts

and the effect on the parties and the worth of the defendants." *Id.* The court rejected Eaton's argument that the punitive damages award must be limited to a reasonable relationship between the award and the wrongdoer's net income (as noted, the proportion here was an unprecedented 62%), and instead ruled that an award constituting 10% of Cutler-Hammer's 1977 net worth "was well within the generally accepted parameters for punitive damages" under the facts of the case. App. A at A-54.

With respect to successor liability, the court held that California law permits punishment of an innocent successor corporation. The court relied principally on *Moe v. Transamerica Title Ins. Co.,* 21 Cal.App.3d 289, 98 Cal.Rptr. 547 (1971). App. A at A-52 to A-53. That case permitted successor liability for punitive damages under facts where the successor and predecessor shared an identity of interest so that the two corporations were "one and the same" and the successor "made no attempt in the trial court to contend that it was a corporation separate and distinct from [the predecessor] or that it was subject to a different standard of liability." *Moe v. Transamerica, supra,* 21 Cal.App.3d at 303.[6] The court did not suggest, however, that Eaton shared any identity of interest with Cutler-Hammer either before or after the merger, and the evidence at trial was to the contrary.

On May 16, 1988, this Court handed down its decision in *Banker's Life.* Only three months later, Eaton brought that decision to the attention of the California Supreme

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[6]The court of appeal additionally cited *Marks v. Minnesota Mining & Manufacturing Co.,* 187 Cal.App.3d 1429, 232 Cal.Rptr. 594 (1986), stating that *Marks* "adhered to the rule in *Moe.*" App. A at A-52 to A-53. As discussed *infra, Marks* also permitted successor liability for punitive damages where the predecessor and successor were effectively the same.

Court in Eaton's Petition for Review, and urged the California court to overrule its prior decisions upholding the constitutionality of unrestricted punitive damages and to find that the imposition of $15,000,000 against Eaton under the facts of this case violated the federal Due Process and Excessive Fines clauses.[7]

B. Presentation of the Federal Questions To The California Courts

Eaton argued in its Petition for Review before the California Supreme Court that the recent decision in *Banker's Life* mandated consideration of the constitutionality of the punitive damages award in this case under both the federal Due Process Clause and the Eighth Amendment Excessive Fines Clause. Eaton asked the California Supreme Court to "fully evaluate [these] Constitutional arguments," even though existing California precedent was to the contrary. As stated in the Petition for Review:

> In the words of Justice Powell in another context, [punitive damages] are "limited only by the gentle rule that they not be excessive," *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974), and cannot be forecast with any reliability. A company, trying to determine whether to merge with another, can make no reliable assessment of the value of its potential purchase and stockholders cannot know whether their officers and directors are proceeding reasonably. Here, when Eaton bought Cutler-Hammer, no one could forecast that the price tag would be an additional $15,000,000. This very absence of standards may well render such damages unconstitu-

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[7] *Banker's Life* was decided over one year after the parties' opening, responding and reply briefs in the court of appeal were submitted.

> tional on due process grounds. *See Banker's Life & Casualty v. Crenshaw*, [citations omitted] (Scalia, J. concurring).
>
> [Eaton's Petition for Review, p. 12, App. G at G-17 to G-18.]

Eaton's Petition continued:

> Three months ago in *Banker's Life & Casualty Co. v. Crenshaw, supra*, the U.S. Supreme Court noted that punitive damages awards raise important Constitutional questions which must be addressed. These issues include whether punitive damages, such as those awarded here, constitute an excessive fine, and whether they violate due process. (U.S. Const., Amend. VIII, XIV; Calif. Const., Art. I, § 7(a) and § 17.) Until *Banker's Life*, this Court had seemed to uphold such damages. *Peterson v. Superior Court*, 31 Cal.3d 147, 181 Cal.Rptr. 784 (1982). We believe that *Banker's Life* instructs state courts of last resort to reexamine such questions, and to fully evaluate the Constitutional arguments.
>
> [Eaton's Petition for Review, pp. 12-13 n. 6, App. G at G-18.]

Eaton further argued that these same constitutional issues were aired in the Petition for Review in the *April Enterprises v. KTTV* matter, then pending before the state high court. Eaton's Petition for Review was denied by the California Supreme Court on November 16, 1988, without comment.[8] App. D at D-1.

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[8]As noted, this denial followed less than three months after the court likewise denied the Petition for Review in the *April Enterprises v. KTTV* matter.

Under the traditional test applied by this Court, Eaton's presentation of the federal question to the California Supreme Court provides ample basis for this Court's review of these issues. This Court has jurisdiction to consider federal issues which have been either "raised or considered and resolved in state court." *Illinois v. Gates,* 462 U.S. 213, 218 n.1 (1983). As stated most recently in *Banker's Life,* "there should be no doubt from the record that a claim under a *federal* statute or the *Federal* Constitution was presented in the state courts and that those courts were apprised of the nature and substance of the federal claim at the time and in the manner required by the state law." *Banker's Life, supra,* 108 S.Ct. at 1650, citing *Webb v. Webb*, 451 U.S. 493, 501 (1981).[9]

Under settled California law, Eaton's constitutional arguments were properly raised before the state high court in Eaton's Petition for Review. California law unequivocally provides that, "[p]arties may advance new theories on appeal when the issue posed is purely a question of law based on undisputed facts and involves important questions of public policy." *Fisher v. City of Berkeley,* 37 Cal.3d 644, 654 n.3, 209 Cal.Rptr. 682, 692 n.3 (1984). This applies with special force where the petitioner is asking the court to overrule prior precedent. The rule was applied by the California Supreme Court most recently in *Moradi-Shalal v. Fireman's Fund Ins. Co.,* 46 Cal.3d 287, 250 Cal.Rptr 116 (1988), a decision directed entirely to an issue raised for the first time in the

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[9]This is not a case such as *Webb*, where the petitioner could not overcome the presumption that the state court failed to pass upon the federal question as a result of petitioner's failure to indicate in the state court his reliance on the federal issue. Here, Eaton specifically relied on the federal Due Process Clause and Excessive Fines Clause in support of its constitutional arguments.

defendant's Petition for Review before that court, namely, whether the court should overrule its prior decision in *Royal Globe Ins. Co. v. Superior Court,* 23 Cal.3d 880, 153 Cal.Rptr. 842 (1979). The court, noting that "defendant did not raise the issue in the lower courts" (36 Cal.3d at 292, n.1), stated in language equally applicable here that:

> [C]learly it was pointless for defendant to ask either the trial or appellate court to overrule one of our decisions. The original petition for review squarely raised the point. . . . Accordingly, the *Royal Globe* issue is properly before us.
>
> [*Id.*]

Eaton thus satisfied the California rule before bringing its arguments to this Court. PKL itself noted that Eaton's constitutional attacks on punitive damages raised in the California Supreme Court were contrary to established precedents. In PKL's Answer to Eaton's Petition for Review, PKL stated: "This Court and the courts of appeal have repeatedly rejected the constitutional challenges to punitive awards which Eaton appears to assert here. (Citations omitted.)" PKL's Answer at p. 9 n.8.

Moradi-Shalal, supra, is itself sufficient to demonstrate that under California law Eaton timely raised its constitutional arguments in the state court. *See also Wong v. Di Grazia,* 60 Cal.2d 525, 532 n.9, 35 Cal.Rptr. 241 (1963) (state supreme court considered federal antitrust issue first raised before that court); *Burdette v. Rollefson Construction Co.,* 52 Cal.2d 720, 344 P.2d 307 (1959) (party permitted to change legal theory of case for first time before state supreme court). Indeed, California courts have passed upon constitutional challenges to punitive damages such as those presented here that were appar-

ently raised for the first time on appeal. *See Downey Sav. and Loan Assoc. v. The Ohio Casualty Co.,* 189 Cal.App.3d 1072, 234 Cal.Rptr. 835 (1987), *cert. denied,* 108 S.Ct. 2023 (1988); *Hasson v. Ford Motor Co.,* 32 Cal.3d 388, 485 Cal.Rptr. 654 (1982).[10]

In addition, several Justices of this Court have questioned whether a party can be criticized for failing to assert constitutional rights not yet declared to exist. *Curtis Publishing Co. v. Butts,* 388 U.S. 130, 143 (1967) (plurality opinion of Harlan, J.); *id.,* at 172 n.1 (Brennan, J., joined by White, J.). As noted, in California all challenges to the constitutionality of punitive damages have been rejected for decades *(see Egan v. Mutual of Omaha Ins. Co.,* 24 Cal.3d 819, 169 Cal.Rptr. 691 (1979); *Bertero v. National General Corp.,* 13 Cal.3d 66, 118 Cal.Rptr. 184 (1975)) and until this Court's decisions in *Aetna Life Ins. Co. v. Lavoie,* 475 U.S. 813 (1986) and *Banker's Life,* there was no clear indication that this Court was prepared to address the issue. It serves no purpose to raise legal issues before the state high court which require the reversal of well-established precedent where, as here, the state court has only recently declined to address the issue. *See Downey Sav. and Loan Assoc. v. The Ohio Casualty Co.* (challenging a precedent setting $5,000,000 punitive damages award) and *April Enterprises v. KTTV* (challenging another precedent setting

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[10]Significantly, Justices O'Connor and Kennedy voted to grant certiorari in *Atlantic Richfield Co. v. Nielsen, cert. denied,* 108 S.Ct. 2023 (1988), a case decided even before *Moradi-Shalal,* where the petitioner raised no federal objections to a punitive damages award until filing a Petition for Review in the California Supreme Court. The procedure followed in California is thus much different than the Alabama state rule cited in *Orr v. Orr,* 440 U.S. 268, 275 n.4 (1979) which appears to strictly prohibit the raising of issues before the Alabama Supreme Court which were not raised in the lower courts.

$14,000,000). Thus, even if Eaton had not raised the constitutional challenge to punitive damages under the Eighth and Fourteenth Amendments (though it plainly did), this Court should nevertheless consider the issue now.

REASONS FOR GRANTING THE WRIT

The time is ripe to consider whether the U.S. Constitution in any way constrains the presently unrestrained and standardless imposition of punitive damages. Nine months ago in *Banker's Life*, the Court refrained on prudential grounds from addressing constitutional challenges to a $1,600,000 punitive award, and indicated that state courts and legislatures should address the problem of increasingly frequent and progressively larger awards. Eaton is a victim of California's refusal to heed this Court's direction. By denying review in this case, the California Supreme Court has endorsed another punitive award which breaks new ground as to amount and its relationship to the wealth of the alleged wrongdoer. Perhaps most troubling, this record-setting punishment has been levied against a party (Eaton, as successor to the alleged wrongdoer, Cutler-Hammer) not even accused of wrongdoing. The result was a $15,000,000 fine payable to respondent PKL as a windfall.

Eaton respectfully submits that the problem of recurring unrestrained punitive damages awards is getting worse, not better, and that absent action by this Court, the crisis will continue to deepen.[11]

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[11]A leading empirical study on punitive damages is a 1987 publication by the Rand Corporation's Institute for Civil Justice entitled Peterson, "Punitive Damages — Empirical Findings" (Rand Corp. 1987, pub. no. R-3311-ICJ). The study, based on data from Illinois

I.

This Court Should Decide Whether the Excessive Fines Clause of the Eighth Amendment Applies To a $15,000,000 Punitive Damages Fine.

Recent decisions of this Court recognize that the question whether the Excessive Fines Clause applies to punitive damage awards in civil actions is of substantial importance. *See Banker's Life and Casualty Co. v. Crenshaw, supra*, 108 S.Ct at 1651 ("whether the Eighth Amendment's Excessive Fines Clause serves to limit punitive damages in state civil cases is a question of some moment and difficulty"); *Aetna v. Lavoie*, 475 U.S. 813 (1986) (argument that Excessive Fines Clause and Fourteenth Amendment Due Process Clause restrict punitive damages award "raises important questions which, in an appropriate setting, must be resolved. . . .") The issue

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and California, presents startling facts on punitive damage awards in "business/contract" cases. In the entire 1960's decade, punitive damages were awarded in only four such cases in Cook County, Illinois, and eight cases in San Francisco County, California, for a cumulative dollar total of less than $800,000. In the next decade (1970's) there were 45 punitive damages awards with a cumulative total of about $12 million. Then, in just the first 5 years of this decade (1980-1984) there were 57 punitive awards in the two counties totalling about $31 million. *Id.* at pp. 22-24, 65. The punitive damage award before the Court in this case is more than double the cumulative total of all punitive damages awarded in San Francisco County in the entire decade of 1970-1979, and is virtually equal to the total for 1980-1984. It is not just the frequency and cumulative total of punitive damages awards which have risen so sharply. Rather, the *average* punitive verdict size has exploded in commercial cases from about $64,000 in the 1960's to $500,000 in the period 1980- 1984. In Los Angeles County, California, the current *averages* are astounding in commercial cases: $3.2 million for "bad faith" claims, and $1.2 million for "other" business/contract cases in the 1980-1984 period. *Id.* at p. 39.

arises because, as this Court has also recognized, punitive damages are imposed for the same purpose as criminal penalties — to punish. *International Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42, 48 (1979) (punitive damages are "private fines levied . . . to punish reprehensible conduct"); *Smith v. Wade*, 461 U.S. 30, 59 (1983) ("punitive damages are 'quasi-criminal' . . .") (Rehnquist, J., dissenting).[12] Further, this Court has indicated that the Eighth Amendment applies to proceedings which are not strictly criminal in nature. *Ingraham v. Wright*, 430 U.S. 651, 669 n.37 (1977); *Trop v. Dulles*, 356 U.S. 86 (1958); *Carlson v. Landon*, 342 U.S. 524 (1951).

The appropriateness of applying the Excessive Fines Clause to punitive damages awards is illustrated by the sheer size of the award in this case and the refusal of California courts or legislators to set any limits on the amount or proportion of punitive damage awards. The highest award of punitive damages affirmed in a reported decision in California is the enormous $5,000,000 award upheld in *Downey Sav. & Loan Assoc. v. The Ohio Casualty Co.*, 189 Cal.App.3d 1072, 234 Cal.Rptr. 825 (1987), *cert. denied*, 108 S.Ct. 2023 (1988). The award here eclipses even that record-setting fine, not only in amount, but also in its lack of any proportionality between the size of the award and the wealth of the wrongdoer: the award erased all previous boundaries for the size of a punitive damages fine in reported California decisions. *Compare Downey Sav. & Loan Assoc. v. The Ohio Casualty Co.*, *supra*, 189 Cal.App.3d at 1099-1100 (1.9% net worth, 16.7% net

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[12]This is also the stated purpose of punitive damages under California law. CAL. CIV. CODE § 3294 (exemplary damages may be imposed in addition to actual damages "for the sake of example and by way of punishing defendants"); *see Neal v. Farmers Insurance Exchange*, 21 Cal.3d 910, 148 Cal.Rptr. 389 (1978).

income); *Burnett v. The National Enquirer, Inc.,* 144 Cal.App.3d 991,1019, 193 Cal.Rptr. 206, 223 (1983) ($150,000 punitive damages award: 5.8% net worth, 9.62% net income); *Moore v. Am. United Life Ins. Co.,* 150 Cal.App.3d 610, 636, 197 Cal.Rptr. 878, 894 (1984) ($2,500,000 punitive damage award: 3.2% net assets, 6.3% net income); *Roemer v. Retail Credit Co.,* 44 Cal.App.3d 926, 931, 119 Cal.Rptr. 82, 85 (1975) ($250,000 punitive damages award: 0.63% net worth, 2.78% net income); *Wetherbee v. United Ins. Co. of America,* 18 Cal.App.3d 266, 272, 95 Cal.Rptr. 678, 682 (1971) ($200,000 punitive damage award: 0.33% net assets, 2% net income). If the award in this case stands, it may legitimately be said that there are *no* boundaries left.

In refusing to disturb this award, the California Supreme Court has, without comment, endorsed the unrestrained assessment by juries of punitive fines. The legislature has established no limit, and the trend of California courts is to uphold punitive damages awards which are not only huge in amount (as witnessed by the recent $14,000,000 award upheld in *April Enterprises*), but also increasingly limitless in proportion to the wrongdoer's wealth. In fact, in this case the appellate court ruled that there is no requirement under California law that a punitive award bear any reasonable proportion to the wrongdoer's net income. *See* App. A at A-54. By denying review of precisely this question (*see* App. G at G-4), the California Supreme Court refused to say otherwise.

On the issue of proportion, this case indeed demonstrates that California juries are unconstrained by any legitimate standard or appellate exercise of discretion. In the appellate court, PKL relied heavily, for example, on *Greenfield v. Spectrum Investment Corporation,* 174

Cal.App.3d 111, 219 Cal.Rptr. 805 (1985) where the court upheld a $42,500 punitive damages award constituting an even more incredible 177% of the wrongdoer's *gross* income. Likewise, PKL pointed to *Devlin v. Kearney Mesa AMC/Jeep/Renault, Inc.*, 155 Cal.App.3d 381, 202 Cal.Rptr. 204 (1984), where an $80,000 punitive damages award constituting 17.5% of the wrongdoer's net worth was permitted. *Id.* at 391. Even though the dollar amount of the punitive damages awards in these cases was relatively much lower, the proportion they established was successfully cited as precedent for other cases. In this manner, the court of appeal in this case concluded that the $15,000,000 punitive award rendered against Eaton was "well within the generally accepted parameters for punitive damages." App. A at A-54.

Eaton submits that there are no meaningful proportion "parameters" at all under California law for the imposition of punitive damages. If there is to be any real limit, it will come from this Court's decision that the Excessive Fines Clause requires basic fairness. This Court should act because California's approach is out of line with the Eighth Amendment's mandate for reasonableness and proportion for punishment levied under state law. *See Solem v. Helm*, 463 U.S. 277 (1983).

Solem suggests that an appropriate starting point under the Eighth Amendment is to require legislative decision-making limiting the range of permissible punishment. The Constitution may or may not require a state to adopt a fixed multiplier for all cases; but at a minimum, it does require that the amount of a punitive fine be limited according to clearly defined standards so that an assessment can be made whether the punishment passes constitutional muster for reasonableness and proportion. *See Solem, supra*, 463 U.S. at 286, 288-289. The absence of any

such standards under California law for punitive damages means that monetary punishment for criminal conduct is carefully limited, while civil torts can be punished without limit. Thus, if Eaton had been convicted of a felony for which the law did not prescribe a certain fine, the maximum monetary punishment would be $10,000. CAL. PENAL CODE § 672. Likewise, if Eaton's conduct had been violative of antitrust laws, 15 U.S.C. § 15(a) or RICO, 18 U.S.C. § 1964(c), the punitive damages portion of a treble damages award would be about one-third of the punitive award rendered here.

The time is ripe to consider the Excessive Fines issue. This case presents a strong record for application of the Eighth Amendment, where state law demonstrably permits punitive damages fines absent meaningful standards, and without effective limit regarding the proportion or amount of the fine.

II.

This Court Should Decide Whether the Due Process Clause Prohibits Imposition of Punitive Damages by Juries Having Unfettered Discretion To Determine The Amount of the Fine.

The cornerstone of due process is to prohibit capricious taking of property and imposition of punishment in the absence of clear standards and reasonable notice. *Roberts v. United States Jaycees*, 468 U.S. 609, 629 (1984). Where criminal punishments are involved, due process dictates that "the standard of certainty [must] be higher." *Kolender v. Lawson*, 461 U.S. 352, 359 n.8 (1983). The very purpose and effect of punitive damages is also to punish — indeed, such damages have been likened to criminal penalties. *Rosenbloom v. Metromedia, Inc.*, 403 U.S. 29, 82 (1971) (Marshall, J., dissenting); *Smith v.*

Wade, 461 U.S. 30, 68 (1978) (Rehnquist, J., dissenting). Yet far from requiring "higher standards" for the imposition of punitive damages, under California law Eaton was subjected to punishment in the virtual absence of any standards or limits, based solely on the jury's ad hoc — and post hoc — determination as to the appropriate level of fine. The resulting award was unpredictable, arbitrary and severe. In short, Eaton's property was taken without due process of law.

The due process problem raised here was described by Justice O'Connor in her concurring opinion in *Banker's Life*, joined by Justice Scalia. The opinion appropriately states that the apparent denial of due process arising from the imposition of punitive damages by juries given unfettered discretion to decide punishment is "worthy of the Court's attention in an appropriate case." In language equally applicable to the issue posed by the record here, the opinion states:

> Although [the state law] may describe the required mental state with sufficient precision, the amount of the penalty that may ensue is left completely indeterminate . . . [Under the state law], "the determination of the amount of punitive damages is a matter committed solely to the authority and discretion of the jury." [Citation omitted]. This grant of wholly standardless discretion to determine punishment appears inconsistent with due process.
>
> [*Id.* at 1656.]

The same "wholly standardless discretion" is present here. California Civil Code § 3294 permits punitive damages for "fraud," "oppression" or "malice," but sets no limits on the amount and provides no standards for the jury's determination of damages. *See* App. F at F-2 to

F-3. Thus, the jury here was instructed that "the law provides no fixed standards as to the amount of such punitive damages, but leaves the amount to the jury's sound discretion . . . ." *Id.* at F-2.

Justice O'Connor's opinion touches upon the two interrelated ways that California's punitive damages laws violate due process. First, the carte blanche discretion afforded the jury sharply contrasts with the due process constraints required for criminal punishment. Criminal laws must "demarcate the range of penalties" and thereby "inform . . . the courts, prosecutors and defendants of the permissible punishment alternatives . . ." *United States v. Batchelder,* 442 U.S. 114, 123 (1979). The open-ended power given courts and juries in California to mete out "civil" punishment should be similarly restricted by requiring California to apply due process protections. As stated by Justice Rehnquist, "punitive damages are 'quasi-criminal,' [citation omitted] [yet] their imposition is unaccompanied by the types of safeguards present in criminal proceedings." *Smith v. Wade, supra,* 461 U.S. at 59 (dissenting opinion). The due process clause should not be diluted on the ground that this "quasi-criminal" punishment occurs in a civil case. *See Giaccio v. Pennsylvania,* 382 U.S. 399, 402 (1966) (due process protection "is not to be avoided by the simple label the state chooses to fasten on its conduct or its statute").

Second, the punishment is completely unpredictable. In *International Brotherhood of Electrical Workers v. Foust,* 442 U.S. 42, 50 (1979), the Court, in an opinion by Justice Marshall, forbade punitive damages in unfair representation suits brought against unions under the Railway Labor Act, in part because "the impact of these windfall recoveries is unpredictable and potentially substantial." Likewise, the unpredictability of punitive damages

awards was one reason that the Court in *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 349-359 (1974) forbade the award of punitive damages in defamation suits brought by private plaintiffs. *See also Rosenbloom, supra,* 403 U.S. at 84 ("the essence of the discretion is unpredictability and uncertainty"). As stated by Justice O'Connor, "[f]or similar reasons, the Court should scrutinize carefully the procedures under which punitive damages are awarded in civil lawsuits." *Banker's Life and Casualty Co. v. Crenshaw, supra,* 108 S.Ct. at 1655 (concurring opinion).

The lack of basic due process is aggravated where, as here, the punishment is imposed on an innocent party. Because of the absence of standards or limits, no element of fair notice or predictability is present when a good faith acquirer, like Eaton, performs its "due diligence" in assessing for the benefit of its shareholders the risks and benefits of an acquisition. As discussed *supra,* Eaton had no way to evaluate its potential punitive liability for PKL's claim against Cutler-Hammer. This is especially true because the punitive award ultimately allowed here is *triple* the highest amount in any reported decision in California.[13] In short, the effect of California's present punitive system is not to deter wrongful conduct, but to make impossible responsible corporate conduct for the benefit of shareholders. This untenable result arises solely from the constitutional infirmity of giving juries

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[13]That award is the $5,000,000 punitive damages judgment upheld in *Downey Sav. and Loan Assoc. v. The Ohio Casualty Co., supra,* 189 Cal.App.3d at 1099-1100. Indeed, the highest punitive damages award upheld by the California Supreme Court as of the time of Eaton's acquisition of Cutler-Hammer was only $740,000. *Neal v. Farmers Insurance Exchange,* 21 Cal.3d 900, 148 Cal.Rptr. 389 (1978). Furthermore, as discussed *infra,* the law did not appear to permit imposition of punitive damages against an innocent successor like Eaton under the facts of this case.

total discretion to punish in wholly unpredictable amounts and proportions. This case thus presents a strong record upon which to impose constitutional limitations on punitive damages.

III.

THIS COURT SHOULD DECIDE WHETHER THE DUE PROCESS CLAUSE PROHIBITS IMPOSITION OF UNLIMITED PUNITIVE DAMAGES ON INNOCENT SUCCESSOR CORPORATIONS.

It is fundamental that punishment cannot be imposed on innocent parties, as recognized by this Court nearly one hundred years ago:

> Exemplary or punitive damages, being awarded, not by way of compensation to the sufferer, but by way of punishment of the offender, and as a warning to others, can only be awarded against one who has participated in the offense.
>
> [*Lake Shore & M. S. Ry. Co. v. Prentice,* 147 U.S. 101 (1893).]

The reason is basic: " 'No man should be punished for that of which he is not guilty.' " *Lake Shore, supra,* 147 U.S. at 115 (quoting former Justice Baryton, afterwards chief justice of Rhode Island, in *Hogan v. Railroad Co.,* 3 R.I. 88, 91 (1854)).

This principle finds expression in more recent discussions by this Court as well, and was one of the reasons that the Court forbade the imposition of punitive damages on municipalities in actions brought under 42 U.S.C. Section 1983. In *City of Newport v. Fact Concerts, Inc.,* 453 U.S. 247 (1981) Justice Blackmun, writing for the Court, noted that " '[punitive damages] can never be allowed

against the innocent.'" *Id.* at 261 (citations omitted). Further, the Court observed that no public policy supported the imposition of punitive damages on taxpayers "who took no part in the commission of the tort" (*Id.* at 267) and that "[n]either reason nor justice suggests that such retribution should be visited upon the shoulders of blameless or unknowing taxpayers." *Id.*

Similar arguments have been raised that there is no basis to impose punitive damages on innocent corporate shareholders for the wrongs of corporate agents. *See, e.g., Baptiste v. Superior Court,* 106 Cal.App.3d 87, 164 Cal.Rptr. 789 (1980); *Pease v. Beech Aircraft Corporation,* 38 Cal.App.3d 450, 113 Cal.Rptr. 416 (1974). Eaton here, however, does not urge a broad rule barring punitive damages against corporations. Rather, Eaton submits that whatever rationale might exist for punishing corporations for the acts of their agents, due process forbids imposing punishment on innocent successor corporations for the wrongdoing of distinct predecessor corporations. Such punishment cannot deter wrongdoing, because it is a punishment of a party who had no responsibility for nor control over the wrongful conduct. The penalty is suffered by innocent shareholders who are many times removed from any participation in the alleged wrongful conduct, and who cannot predict with any reasonable basis the kind of fine which may be imposed for the conduct of agents not even employed by the company when the wrongdoing occurred (or when their stock shares were purchased). Any award of punitive damages in that situation is necessarily arbitrary and capricious and, therefore, violates due process.

Prior to the decision of the court of appeal in this case, California law appeared to restrict successor liability for punitive damages to circumstances where the predecessor

and successor shared an identity of interest so that punishment of the successor was, in effect, punishment of the wrongdoer. *Moe v. Transamerica Title Ins. Co., supra,* 21 Cal.App.3d at 303-05; *Marks v. Minnesota Mining and Manufacturing, Co.,* 187 Cal.App.3d at 1434;[14] *In re Related Asbestos Cases,* 566 F.Supp. 818 (N.D. Cal. 1983). This rule is likewise followed in several other jurisdictions. *See Brotherton v. Celotex Corp.,* 202 N.J. Super. 148, 493 A.2d 1337 (N.J. Super. Law Div. 1985); *Martin v. Johns-Manville Corp.,* 332 Pa. Super. 348, 469 A.2d 655 (Pa. Super. 1983), *rev'd on other grounds,* 494 A.2d 1088 (1985); *Sheppard v. A.C. & S. Co., Inc.,* 484 A.2d 521 (Del. Super 1984).[15] As noted, the court of appeal in this case

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[14]Despite certain broad language, the decision in *Marks* plainly followed this rule, permitting imposition of a $75,000 punitive damages award on successor McGhan/Del for the wrongdoing of predecessor McGhan/Cal because the two companies were for all practical purposes identical. *Id.* at 1434-1438. As noted, the Court of Appeal in this case observed that "*Marks* . . . adhered to the rule in *Moe* . . ." Appendix A, at A-52 to A-53.

[15]The rule is the only one consistent with this Court's principles and established law in California that punitive damages may only be imposed against the party actually responsible for the wrong. *Magallanes v. Superior Court,* 167 Cal.App.3d 878, 889-890, 213 Cal.Rptr. 547, 554 (1985); *Ford Motor Co. v. Home Ins. Co.,* 116 Cal.App.3d 374, 380, 172 Cal.Rptr. 59, 63 (1981); *Templeton Feed & Grain v. Ralston Purina Co.,* 69 Cal.2d 461, 469, 72 Cal.Rptr. 344, 350 (1968); *Evans v. Gibson,* 220 Cal. 476, 489-490, 31 P.2d 389, 395 (1934). A few jurisdictions appear to justify the punishment of innocent successor parties on the theory that punishing *innocent parties* deters wrongdoing by others. *See Hanlon v. Johns- Manville Sales Corp.,* 599 F.Supp. 376 (N.D. Iowa 1984); *Wall v. Owens-Corning Fiberglas Corp.,* 602 F.Supp. 252 (N.D. Tex. 1985); *Celotex Corp. v. Pickett,* 490 So.2d 35 (Fla. 1986). As noted, California had, prior to this case, rejected the notion that innocent parties could be punished to deter wrongdoing by others. *Magallanes v. Superior Court,* 167 Cal.App.3d at 889-890. To the extent Respondent would seek to sustain the imposition of

reached a different result, holding that a successor corporation is automatically liable for punitive damages under California Corporations Code Section 1107, which provides simply that a successor is liable for the "debts and liabilities" of a predecessor. App. A-52 n.18.[16]

In permitting punitive damages against Eaton under the facts of this case, however, the California Supreme Court permitted an extension of state law which runs afoul of due process: vicarious punishment of completely innocent parties. This Court should grant the petition here to rule that punitive damages against innocent parties is unconstitutional.[17]

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punitive damages on Eaton under such a deterrent rationale, Eaton submits that due process forbids it and logic does not sustain it. Rather, Eaton submits, responsible corporate efforts to assess and limit risks to the shareholders are deterred when such efforts are rendered meaningless by unpredictable punitive fines.

[16]CAL. CORP. CODE § 1107 codifies law followed by virtually all jurisdictions. The statute is silent, however, on the issue raised here — whether succession to "debts and liabilities" includes assumption of an unknown punitive fine in an unpredictable amount against a successor which shares no identity with the wrongdoer. Section 1107 is quoted in full at App. E.

[17]The lack of justification for punishing an innocent successor is especially apparent where, as here, the punishment is based on the application of a legal standard not established either at the time the predecessor acted or at the time the successor acquired its interest. Here, at the time Eaton acquired Cutler-Hammer, the leading authority, *Moe*, appeared to forbid imposition of punitive damages against a successor sharing no identity of interest. Indeed, in *In Re Related Asbestos Cases*, 566 F.Supp. 818 (N.D. Cal. 1983), the court reached exactly that conclusion. *Id.* at 877. In announcing a new interpretation of California law in this case, the court of appeal retroactively imposed its conclusions on Eaton. In California, however, constitutional challenges to the retroactive applications of a new legal standard permitting punitive damages have been expressly rejected by the state supreme court. *Peterson v. Superior Court*, 31 Cal.3d 147,

CONCLUSION

We urge the Court to review, under the applicable provisions of the United States Constitution, this unprecedented $15,000,000 civil fine. For the reasons set forth above, the petition for certiorari should be granted.

Dated: February 10, 1989

Respectfully submitted,

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181 Cal.Rptr. 784 (1982). Eaton urged the state high court, to no avail, to reconsider *Peterson*. App. G at G-18.

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APPENDIX A

NOT TO BE PUBLISHED

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT
DIVISION FIVE

PKL COMPANIES, INC.
Plaintiff and Respondent,

v.

EATON CORPORATION,
Defendant and Appellant.

2d Civil No. B010958
(Super. Ct. No. C185010)

The Eaton Corporation ("Eaton") appeals from a jury verdict in favor of plaintiff, The PKL Companies, Inc. ("PKL"). After a six-month trial, the jury awarded $2,633,599 in compensatory damages and $15,000,000 in punitive damages. We affirm the judgment.

PROCEDURAL BACKGROUND

PKL filed a multi-count lawsuit against Macrodata Corporation ("Macrodata") and Cutler-Hammer, Inc. ("Cutler-Hammer") and two individuals, Dr. William Mow and J. David Hopkins. Eaton is the successor in interest to both Macrodata and Cutler-Hammer.

This appeal follows a retrial.[1] The case was tried on one count of promissory fraud and a second count of breach of

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[1]Dr. Mow was granted a pretrial dismissal from the lawsuit, and Hopkins was granted a nonsuit in the first trial. The jury in the first trial found against Eaton and awarded PKL $2,250,000 in compensatory damages and $17,500,000 in punitive damages.

fiduciary duty. After a six-month trial, the jury returned a general verdict against Eaton on both causes of action, awarding PKL $2,633,599 in compensatory damages and $15,000,000 in punitive damages.

APPELLANT'S CONTENTIONS

Eaton contends that the trial court lacked jurisdiction as to the promissory fraud count and that PKL could not sue individually on the breach of fiduciary count except in a derivative capacity. Eaton also asserts that the trial court committed procedural and evidentiary errors which require reversal. Eaton further contends that the evidence was insufficient to support the judgment. Numerous instructional errors are also cited by Eaton. Eaton further contends that it was prejudiced by the misconduct of both the trial court and PKL's counsel. Finally, Eaton asserts that not only were the compensatory and punitive damages excessive, but that punitive damages may not be assessed against a successor corporation.

STATEMENT OF FACTS

As part of a 1972 investment agreement with Macrodata, a Calfornia corporation which manufactured semiconductor test equipment, PKL received 160,011 shares of restricted Macrodata stock. Because this unregistered stock could not be transferred or sold publicly, the agreement gave PKL the contractual right to require Macrodata to register the shares with the Securities Exchange Commission (SEC) to make the stock publicly tradable.

In 1974 and 1975, Cutler-Hammer, an industrial and electrical equipment conglomerate based in Milwaukee, Wisconsin, sought control of Macrodata and began pri-

vately acquiring the latter's stock. These private transactions were unreported, thus keeping the stock price down. Designing to purchase 100 percent of Macrodata's stock, Cutler-Hammer developed an acquisition plan which would treat minority shareholders such as PKL unfavorably. This plan was documented in a July 1974 memo from Hopkins to Fitzgerald which stated, in part: "I believe we should, at these depressed market levels, buy the Nixdorf [another Macrodata shareholder] and PKL interests in Macrodata (in that order) and then negotiate with Mow for the balance. By doing this, we can average out our share price over the whole lot to balance the high price Mow will want for the remainder."

When Cutler-Hammer's ownership of Macrodata stock increased to over 30 percent, Hopkins, the Cutler-Hammer vice president in charge of the Macrodata acquisition, and Charles Wampler, a member of Cutler-Hammer's board of directors, became members of Macrodata's board of directors. By June 1975, through its private purchases, Cutler-Hammer had become Macrodata's majority shareholder, owning 59 percent of the latter's outstanding shares.

In the meantime, PKL had declined to sell its Macrodata stock for the $12 price offered by Cutler-Hammer. Desiring to make a pre-liquidation distribution to its own shareholders, PKL wrote to Macrodata on May 29, 1975, demanding registration of its Macrodata shares. According to the investment agreement, PKL was entitled to have its shares registered "as soon as possible." PKL's refusal to sell privately at the Cutler-Hammer low price, coupled with the threat of a PKL distribution to its own stock holders of registered Macrodata shares, sharply raised the likelihood that Cutler-Hammer would

have to pay considerably more in order to achieve 100 percent ownership.

A July 17, 1975, letter from Macrodata's attorney promised to prepare a registration statement for PKL's Macrodata's stock. However, no action was taken throughout the remainder of 1975 to register PKL's Macrodata's stock. By September of 1975, Macrodata's general counsel, Harold Kant, had informed Cutler-Hammer of his fear that Macrodata would be sued by PKL "unless Macrodata moves on the registration." By this time, PKL had repeated its demand for registration and had threatened legal action if registration activity were not commenced.

Inasmuch as Cutler-Hammer's purchases of Macrodata stock were made only in unreported private transactions, Hopkins wrote Cutler-Hammer's chairman, E.B. Fitzgerald, that there was "little chance that these shares will move up unless Macrodata reports substantial earning growths or [Cutler-Hammer] goes after Macrodata's shares on the open market," making it "difficult for PKL to show damages from the delay [in registration]." Cutler-Hammer instructed Kant to inform PKL that registration would occur in conjunction with year-end audit work which was still several months away, and Kant so informed PKL.[2] Cutler-Hammer meanwhile continued in

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[2]In what PKL describes as a "contingency plan" concerning the Cutler-Hammer acquisition scheme, a memorandum from Hopkins to Fitzgerald on January 6, 1976, discussing the lawsuit which PKL had by that time filed, stated the following: "However, if the suit goes before a judge, one strategy we might consider is that of offering to purchase the PKL shares at some low value suitable to us which might be construed by the judge as a fair level and having this as a court supervised offer. If PKL were to accept, then the purchase would be made under court jurisdiction, and would likely remove any

its efforts to purchase PKL's Macrodata stock at what PKL describes as a distress sale price. PKL steadfastly refused to sell.

In September of 1975, a recession year for many industrial enterprises, Cutler-Hammer's chairman, Fitzgerald, publicly predicted that Cutler-Hammer would earn $4 per share for the year, considered a high amount in light of the recession conditions. As the majority owner of now more than 60 percent of Macrodata's outstanding shares, Cutler-Hammer needed to consolidate Macrodata's profits and losses into its own 1975 financial statement. Obviously, Macrodata's financial performance stood to bear upon Cutler-Hammer's ability to meet Fitzgerald's prediction.

In November 1975, Cutler-Hammer sent George Thomas, its manager of internal audit, to Macrodata on a "special assignment" ostensibly to help Macrodata meet Cutler-Hammer's January 1976 financial deadline. Evidence at trial indicated that another aspect of this assignment, however, was to "make Macrodata look good" to bolster the chances that Fitzgerald's $4 per share minimum earnings prediction for Cutler-Hammer would be achieved.

Soon after he commenced work with Macrodata's audit, Thomas recognized that there were difficulties with Macrodata's accounts receivable and its inventory, which was excessive and obsolescent. Although Thomas spoke with one of the outside accountants in charge of Macrodata's audit about the inventory problem, Thomas did not indicate that Macrodata's financial records inaccurately reflected the extent of the inventory problem.

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claim in the future should we exchange shares with other shareowners at a ratio indicating a higher value for the Macrodata shares."

By early 1976, it was estimated that Macrodata would incur at least a $2.4 million loss for 1975 which could well go higher. Thomas told Macrodata financial officers responsible for the 1975 financial statement that "my boss at Cutler-Hammer says hold the loss at $2.2 million" and instructed them not to correct inventory errors which would have increased the loss amount. On January 16 or 17, 1976, Macrodata officially reported to Cutler-Hammer that its loss for 1975 would be $2.28 million. Cutler-Hammer then publicly announced earnings of $4.02 per share which fulfilled Fitzgerald's $4 per share minimum earnings prediction.

By February 1976, Hopkins was well aware of the inaccuracies in Macrodata's 1975 financial statement, but, although he had become chairman of Macrodata's audit committee in January 1975, Hopkins took no action to inform the outside auditors of the discrepancies.

By the end of February 1976, Thomas had ascertained that the inventory had been overvalued by more than $1.24 million. None of this information was revealed to Macrodata's outside auditors before late April 1976.

Cutler-Hammer officials, however, decided to permit Macrodata's false financial statement for 1975 to be made public prior to any Cutler-Hammer official revealing the falsity of the accounting. In this manner, responsibility for the deceptive statement would be placed at the feet of Macrodata and its president, Mow, and deflect negative reactions away from Cutler-Hammer. This strategy is reflected in a memorandum Hopkins wrote to Fitzgerald which states: "In my opinion, it is best in the short run to continue Mow in his present role. I feel that as a minimum this should be done through the time of the Macrodata annual meeting, April 28. This will maintin Mow in a responsible position until 1975's activities are fully re-

ported to the shareowners over his signature." On March 24, 1976, Hopkins had a private discussion with another member of Macrodata's audit committee informing him of the false financial entries. That committee member in response suggested that the SEC be notified to suspend trading in Macrodata stock so that the audit committee members would be protected. Hopkins, however, with the aid of a Cutler-Hammer attorney, convinced the other committee member to hold off.

On April 1, 1976, the outside auditing firm of Macrodata issued the certification for the Macrodata 1975 annual financial report, a copy of which was sent to Hopkins. Macrodata's audit committee, consisting of Hopkins and two others, met on April 8, 1976, with two accountants from the outside auditing firm and with Thomas. None of the Macrodata or Cutler-Hammer officials revealed the problems with the overstated inventory and accounts receivable.

At Hopkins' request, Macrodata's board of directors held a special meeting April 21, 1976. At that meeting, Hopkins characterized Thomas' findings as "post-audit" revelations and blamed Macrodata's management for fraud and false accounting. Hopkins did not indicate that he had had knowledge of the problem for several months. Hopkins suggested that Macrodata call the SEC and have it suspend trading. Mow and Kant objected to Hopkins' charges and Kant stated that he suspected "a conspiracy to drive the value of Macrodata down in order for Cutler-Hammer to take over Macrodata." Kant also remarked that suspension of trading by the SEC "would be used as a coercive device by Cutler-Hammer to take over the balance of the stock at $2 per share."

Shortly after the board meeting, Hopkins instructed Kant to contact the SEC and request a suspension of

trading and that request was made a few days later. On April 23, 1976, two days after the board meeting, Hopkins contacted Macrodata's accounting firm and revealed to it the errors in Macrodata's financial statement. Hopkins told the auditors that the financial statement contained material inaccuracies and that Macrodata was considering suing the accounting firm.

As a result of these actions, the accounting firm withdrew its certification of the 1975 financial statement and commenced a reaudit. Macrodata held another board meeting on April 29, 1976, at which Mow resigned under pressure from Cutler-Hammer officials. Cutler-Hammer then took control of Macrodata's board of directors with a Cutler-Hammer executive succeeding Mow as president. On reauditing Macrodata's 1975 financial statement, the auditors found that the inventory had been overvalued by approximately $1,250,000. The SEC suspended trading in Macrodata's stock for a period of 10 days, commencing on April 29, 1976. In October 1976, Macrodata's financial statement was revised to show a loss of $4,531,000 instead of the $2.28 million previously reported. As was to be expected, confidence in Macrodata's investment potential and its management's integrity was destroyed and trading in its stock never resumed.

In the meantime, PKL had filed a federal court action in January 1976, seeking to compel registration of its Macrodata stock. Unaware of the machinations concerning the false financial statement, PKL was again promised registration in February 1976. However, near the end of February 1976, PKL received from Macrodata a draft of a request for a "no-action" letter as a possible alterna-

tive to registration.[3] The formal request for a no-action letter was mailed to the SEC on March 1, 1976, a full nine months after PKL had first made its registration request and almost two months after PKL had filed its federal lawsuit.

On April 5, 1976, the SEC wrote Macrodata's securities counsel, stating that part of the no-action letter request had been granted and part had been denied. PKL received a copy of the SEC letter just eight days prior to Cutler-Hammer's disclosure that Macrodata's financial statement was false. The letter had arrived too late to be of any value to PKL. Moreover, although the SEC agreed to take no action as to PKL's distribution of its Macrodata stock to its shareholders, it did not agree to refrain from taking action concerning trades of the stock by the individual shareholders. Thus, the no-action letter was virtually useless and of no value to PKL, since it could distribute and liquidate its Macrodata shareholdings but its shareholders would be left holding untradable stock. In any event, the market for Macrodata stock was permanently destroyed a few days later.

Cutler-Hammer completed its acquisition of Macrodata by a merger agreement in September 1977. By this time, Cutler-Hammer held 72 percent of Macrodata's outstanding shares. Cutler-Hammer had previously requested the investment banking firm of Morgan Stanley to render an opinion as to the value of Macrodata's shares. Using a method of valuation which PKL considered suspect, Morgan Stanley's opinion of July 26, 1977, placed the value of Macrodata's shares at $4.40 per share. However, in re-

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[3]A "no action" letter from the SEC can be an alternative to stock registration. In essence, the SEC states its approval for trading of a certain stock and binds itself not to take any legal action in the event of such trading.

ports made in April and July 1977 privately to Cutler-Hammer, Morgan Stanley, using a different method of valuation, had placed the values on Macrodata stock as high as $16.34 and $16.40 per share.

Based on the public valuation of $4.40 per share, Cutler-Hammer set the exchange rate for Macrodata's share in the merger at .165 Macrodata shares for each Cutler-Hammer share. PKL presented evidence at trial indicating the value of the shares should have been at least four times greater than the $4.40 amount actually used and thus the exchange ratio should have been four times higher (i.e., .66). The evidence presented by PKL indicated that it should have received for its Macrodata shares $2,633,599 more. It was this amount that the jury awarded as compensatory damages.

DISCUSSION

I.

COLLATERAL ESTOPPEL

In various contexts, Eaton repeatedly contends that PKL is collaterally estopped as to the fraud count by virtue of an appeal PKL took from the judgment awarding nonsuit to defendant Hopkins in the first trial of this matter.[4] Taking partial statements somewhat out of context, Eaton maintains that the Court of Appeal in its opinion in the *Hopkins* matter held that Hopkins did not

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[4]A copy of the unpublished opinion in that appeal rendered by Division One of this appellate district (2 Civil 68316) on July 5, 1984, has been provided to this court as Exhibit A of the appendix to Eaton's opening brief. As requested by Eaton, we take judicial notice of this document pursuant to Evidence Code section 452, subdivision (d)(1) and section 459, subdivision (a).

interfere with the PKL/Macrodata agreement concerning registration and that PKL did not rely on any alleged misrepresentations, concealments or manipulations. However, PKL is not collaterally estopped by the previous Court of Appeal opinion since that opinion was expressly limited by the court as to its holding.[5]

In the very introduction to the *Hopkins* opinion, the court stated: "This appeal, however, has been taken by plaintiff PKL solely from the judgment rendered below awarding nonsuit to defendant J. David Hopkins, which was a final judgment (Code Civ. Proc., § 904.1). The issues presented on this appeal are limited to those which concern the personal tort liability of Hopkins . . . ."

Likewise, the passages cited by Eaton on this issue indicate clearly that the court's focus was on the evidence relating to the personal liability of Hopkins.

Both the limitation specified by the court in its introduction to the opinion and the whole context of the passages cited by Eaton clearly indicate that Division One's opinion does not preclude any adverse finding as to Eaton's liability on the fraud count. That court's opinion recognizes that Eaton's liability may rest on acts accomplished by Macrodata and Cutler-Hammer, as well as their agents and employees.

Application of the principles of res judicata and collateral estoppel are discussed in *Columbus Line, Inc. v. Gray*

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[5]Division One noted in its opinion that Eaton had successfully obtained an order for a new trial after the first jury trial resulted in a verdict against it for $20.25 million. In footnote 3 of the opinion, Division One stated as to the new trial: "That trial has been completed, and the jury awarded $2,633,599 in compensatory damages and $15 million in punitive damages. An appeal by Eaton from the second jury verdict is now pending."

Line Sight-Seeing Companies Association, Inc. (1981) 120 Cal.App.3d 622, 628-629: "The doctrine of res judicata provides that a final judgment on the merits bars the parties or those in privity with them from litigating the same cause of action in a subsequent proceeding and collaterally estops parties or those in privity with them from litigating in a subsequent proceeding on a different cause of action any issue actually litigated and determined in the former proceeding. (*In re Russell* (1974) 12 Cal.3d 229, 233; *Martin v. Martin* (1970) 2 Cal.3d 752, 758; *Merry v. Coast Community College Dist.* (1979) 97 Cal.App.3d 214, 221.) The application of the doctrine in a given case depends upon an affirmative answer to three questions: (1) Was the issue decided in the prior adjudication identical with the one presented in the action in question? (2) Was there a final judgment on the merits? (3) Was the party against whom the plea is asserted a party or in privity with a party to the prior adjudication? (*Levy v. Cohen* (1977) 19 Cal.3d 165, 171; *Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd.* (1962) 58 Cal.2d 601, 604.)"

We need go no further than the first question. As stated in the *Hopkins* opinion, the issue decided there was that of Hopkins' personal liability, not Eaton's as the successor in interest to both Macrodata and Cutler-Hammer. There being no identity of the issues, the doctrine is not applicable. Furthermore, a second portion of the *Hopkins* opinion deals with the interference with business advantage cause of action, which is not part of the instant appeal. Finally, Hopkins was not a defendant as to count seven, the breach of fiduciary duty cause of action.

In any event, Eaton may not safely maintain that the evidence presented at the second trial, even concerning Hopkins, was identical to that presented at the first trial.

For example, the second trial resulted in the production of certain memoranda and a letter written by Hopkins in March 1976 which Eaton had failed to furnish pursuant to discovery requests prior to the first trial in this matter.[6] These documents indicate that Cutler-Hammer officials not only knew that Macrodata's 1975 financial statement was false and incorrect but that they also intentionally refrained from taking action to have the statement corrected until after it had been filed with the SEC and published. This evidence lends support to the PKL contention that Cutler-Hammer planned to permit publication of Macrodata's 1975 financial statement, knowing that the statement set forth false information.

Plainly, it would be inappropriate to apply the doctrines of res judicata and collateral estoppel so as to preclude PKL from going forward in the instant matter.

We likewise find wholly unmeritorious Eaton's related contention that section 916, subdivision (a) of the Code of Civil Procedure divested the trial court of jurisdiction to proceed on the case before us once the notice of appeal in *Hopkins* had been filed. That section expressly provides that "the trial court may proceed upon any other matter embraced in the action and not affected by the judgment or order." The second trial in this case against Eaton and its predecessors in interest was not affected by a determination of the personality liability of one officer, namely Hopkins.[7]

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[6]Whether the failure to provide such discovery was intentional or an inadvertent is not at issue here.

[7]We are likewise unpersuaded that the California Supreme Court decision in *Southern Pacific Co. v. City of Los Angeles* (1936) 5 Cal.2d 545 mandates identity of results as to liability in this case. The *Southern Pacific* decision merely held that it was within the proper function of the state supreme court to eliminate confusion between

We thus hold that the trial court did not lack jurisdiction in this case and that PKL is not barred from proceeding by reason of any collateral estoppel arising out of the *Hopkins* appeal.

II.

THE DERIVATIVE SUIT CLAIM

Eaton contends that PKL's breach of fiduciary duty claim must be barred because it can only be asserted through a stockholder's derivative action. Contending that the gravamen is simply injury to Macrodata and relying principally upon *Sutter v. General Petroleum Corp.* (1946) 28 Cal.2d 525, Eaton asserts that PKL was required to "prove wrongful conduct totally independent from the plaintiff's status as a shareholder." Based on the facts in the instant case, Eaton's claim is unmeritorious.

Aside from the fact that no language requiring proof of "wrongful conduct totally independent from the plaintiff's status as a shareholder" appears in *Sutter, supra,* at pp. 531-532 (the pages cited by Eaton), more recent case law clearly shows the contention is meritless.

The state Supreme Court in *Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93 held that an individual cause of action exists where minority stockholders are injured when majority shareholders "use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionally and must not conflict with the proper conduct of the

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two appellate court decisions relating to the legal effect of undisputed evidence which was identical in both cases. Such a situation does not exist in the instant case.

corporation's business." (*Id* at p. 108.) In *Jones,* the Court noted, the plaintiff did "not seek to recover on behalf of the corporation for injury done to the corporation by defendants . . . [a]lthough she [did] allege that the value of her stock has been diminished by defendants' actions . . . ." (*Id.* at p. 107.) Even in the *Sutter* decision, the Supreme Court held that "a stockholder may sue as an individual where he is directly and individually injured although the corporation may also have a cause of action for the same wrong." (*Sutter v. General Petroleum Corp., supra.* 28 Cal.2d at p. 530.)

The injury to PKL roughly parallels the injury done to the plaintiff in *Jones v. H. F. Ahmanson & Company, supra.* It is the destruction of the market for and the value of the stock peculiarly held by both PKL and Jones which lay at the heart of the complaint in each case. In each case, the majority stockholders had carved out advantageous positions and the value of their stock was secure with no detriment to the corporation itself. In the *Ahmanson* decision, the majority stockholders had become the majority shareholders of the surviving corporation, a holding company through which they continued to control the subservient corporation. The principal asset of the holding corporation was the subservient corporation's stock. The minority shareholders were not offered an opportunity to exchange their shares for holding corporation shares on the same basis as the majority stockholders. The case pleaded by PKL involves essentially the same considerations, albeit the mechanism by which the minority's stock became untradable is not that which was employed in the *Ahmanson* case.

Another case providing a striking parallel to PKL's situation is *Crain v. Electronic Memories & Magnetics Corp.* (1975) 50 Cal.App.3d 509. Crain and other plain-

tiffs were computer engineers, programmers and data processing specialists who, with others, had designed and developed a comprehensive data processing system for fast food restaurants. These plaintiffs assigned all their patent rights in the computer system, as well as an operating prototype, to a corporation known as DSC. As with Macrodata, DSC in its early years required substantial amounts of new capital in order to finance expansion and meet its expenses. A second corporation, EMM, agreed to provide DSC with new capital. EMM also agreed that upon becoming the majority shareholder, it would register the minority shares in order to create a public market for them, just as Cutler-Hammer became responsible upon merger for the agreement Macrodata had with PKL concerning its stock. EMM did in fact seek to gain control of the corporation just as Cutler-Hammer did and subsequently removed the chief executive officer of DSC, refused to register the plaintiffs' shares and left the plaintiffs holding untradable shares and a shell corporation since the assets of DSC were in essence transferred to EMM. (*Id.* at pp. 512-517.)

In *Crain,* the trial court dismissed the complaint (which included causes of action for breach of fiduciary duty and fraud) on the ground that the claims were derivative rather than individual. The Court of Appeal reversed, holding that "the minority shareholders in the instant case suffered injury which entitled them to bring suit in their individual capacities." (*Id.* at p. 522.) The court further held that the plaintiffs' cause of action based upon the contractual obligation to register the minority stock was a breach of fiduciary duty claim individual in nature and not derivative. (*Id.* at p. 523.)

Based on these sound authorities and the parallel situations they set forth, we have no difficulty in finding

that PKL properly brought its claims in its individual capacity.

Eaton further contends that PKL presented a case to the jury which constituted a material variance from that pleaded insofar as the complaint rested on a claim that Eaton's predecessors in interest drove down the value of PKL stock and the jury was presented with evidence of an unfair merger. This contention will be addressed elsewhere in this opinion. (*Post*, Part V.) However, in conjunction with this contention, Eaton also asserts that PKL was improperly permitted to challenge the value placed on its stock as a consequence of the Cutler-Hammer/Macrodata merger. This assertion rests on a claim that such a challenge and presentation of evidence regarding it are barred by California Corporations Code section 1312, subdivision (a). That statute provides: "No shareholder of a corporation who has a right under this chapter to demand payment of cash for [its] shares . . . shall have any right at law or in equity to attack the validity of the reorganization or short form merger, or to have the reorganization or short form merger set aside or rescinded, except that an action to test whether the number of shares required to authorize or approve the reorganization have been legally voted in favor thereof." Citing *Sturgeon Petroleums, Ltd. v. Merchants Petroleum Co.* (1983) 147 Cal.App.3d 134, Eaton contends that PKL's exclusive remedy was an appraisal action and that PKL cannot bring an action at law for "unfair merger" since it has waived its appraisal right. We do not accept Eaton's argument.

First, the *Sturgeon* case applies the rule of exclusivity in the instance of a dissenting shareholder who has demanded payment of cash in exchange for its shares. The record does not indicate that PKL made such a

demand. Secondly, the *Sturgeon* case recognizes the exception to the exclusivity rule, which exception is set forth in subdivision (b) of section 1312 of the Corporations Code. In *Sturgeon,* the court emphasized that the exclusivity rule does not apply if one of the merging corporations is controlled by the other. The court stated: "That the Legislature intended to maintain the exclusivity of the appraisal remedy for dissenting shareholders is apparent not only from its basic reenactment of former section 4123 in subdivision (a) of section 1312, but also from its enactment of subdivisions (b) and (c), which were not found in former versions of the statute and which *expressly permit shareholder litigation other than appraisal action where one of the merging corporations is controlled by the other or where the corporations are under common control.*" (*Sturgeon Petroleums, Ltd. v. Merchants Petroleum Co., supra,* at p. 140 (emphasis added; footnote deleted).)[8]

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[8]Subdivision (b) of section 1312 of the Corporations Code reads as follows: "If one of the parties to a reorganization or short-form merger is directly or indirectly controlled by, or under common control with, another party to the reorganization or short-form merger, subdivision (a) shall not apply to any shareholder of such party who has not demanded payment of cash for such shareholder's shares pursuant to this chapter; but if the shareholder institutes any action to attack the validity of the reorganization or short-form merger or to have the reorganization or short form merger set aside or rescinded, the shareholder shall not thereafter have any right to demand payment of cash for the shareholder's shares pursuant to this chapter. The court in any action attacking the validity of the reorganization or short-form merger or to have the reorganization or short-merger set aside or rescinded shall not restrain or enjoin the consummation of the transaction except upon 10-days prior notice to the corporation and upon a determination by the court that *clearly no other remedy will adequately protect the complaining shareholder* or the class of shareholders of which such shareholder is a member."

The Supreme Court in *Steinberg v. Amplica, Inc.* (1986) 42 Cal.3d 1198, adopted the basic position set forth in *Sturgeon Petroleums, Ltd. v. Merchants Petroleum Co., supra,* 147 Cal.App.3d 134, and ruled that subdivision (a) of section 1312 of the Corporations Code barred claims for breach of fiduciary duty and fraud in connection with a merger. Nonetheless, the Supreme Court also recognized the exception set forth in subdivision (b) of that same Corporations Code provision. It stated: "Our references to appraisal as an 'exclusive remedy' are to be understood as referring to mergers in which one merging corporation does not control the other and they are not under common control. (Cf. § 1312, subd. (b).)" (*Steinberg v. Amplica, Inc., supra,* 42 Cal.3d 1198, 1202, fn. 3.)

Section 1312, subdivision (a) therefore does not preclude PKL from bringing this action nor from presenting evidence on the fairness of the price it received for its stock, since one of the merging corporations was controlled by the other, and PKL did not demand cash for its shares nor ever sued for appraisal. In fact, PKL's lawsuit is not an attack on the merger itself and therefore section 1312, subdivision (a) is not applicable. In any event, however, even if this action were deemed an attack on the validity of the merger, the exception provided by subdivision (b) of section 1312 would permit PKL to bring it.

III.

RIGHT TO JURY TRIAL

Eaton contends it was improper to afford PKL a jury trial because PKL's breach of fiduciary duty cause of action was one in equity. Eaton's contention is not well taken.

In *Mortimer v. Loynes* (1946) 74 Cal.App.2d 160, the basis of the action was, as in this case, a breach of fiduciary duty. The plaintiff, a building and loan commissioner acting as the liquidator of a building and loan association, sought to recover money wrongfully withheld by the defendants from the association in connection with the sale of an apartment building belonging to the association. It was alleged that one of the officers of the association had violated his duty of fair dealing owed to the association and with the aid of others had profited personally at the expense of the association. (*Id.* at pp. 163-167.) The court stated: "Equitable principles furnish the standard by which to measure the conduct of the defendants in this transaction. When this standard is applied the result is, insofar as the pleadings are concerned, that the defendants have a specific sum of money out of which they have defrauded the association, and which, therefore, they are not entitled to retain. [Citations.] From the fact that equitable principles are thus used to establish the alleged liability of the defendants, it does not necessarily follow that the action to enforce that liability is equitable. The law courts now recognize and apply many equitable principles and grant relief based thereon where, as here, legal relief is sought in the form of a judgment for a specific amount. (See *Philpott v. Superior Court* (1934), 1 Cal.2d 512; *McCall v. Superior Court* (1934), 1 Cal.2d 527; *Crouser v. Boice* (1942), 51 Cal.App.2d 198; and *Money Had and Received, and Equitable Action at Law,* by Judge Edward T. Bishop, 7 So.Cal.L.Rev. 41.) None of the extraordinary powers of a court of equity are required in order to give plaintiff the relief that he seeks. A court of law can afford complete relief. It is thus apparent that this action is one at law. [Citations.]" (*Id.* at pp. 167-168.) Similarly, while equitable principles may establish Eaton's liability in the in-

stant case, the relief actually sought by PKL — a money judgment for damages — does not in any respect require exercise of the extraordinary powers of a court of equity. Just as in *Mortimer*, it is apparent that PKL's action is one at law and that PKL was entitled to try this action to a jury.

The cases relied on by Eaton are distinguishable. In *Southern Pac. Transportation Co. v. Superior Court* (1976) 58 Cal.App.3d 433, the court held the action to be equitable because the statute under which the action was brought required the court, as a matter of statutory interpretation, to exercise equitable powers. (*Id.* at p. 437.) The case of *C & K Engineering Contractors v. Amber Steel Co.* (1978) 23 Cal.3d 1 does not deal with the issue before us, but rather "was based entirely upon the equitable doctrine of promissory estoppel." (*Id.* at p. 5.) There, although damages were sought, the trial court was requested to exercise its power to enforce a gratuitous promise, a power belonging exclusively to the courts of equity. (*Id.* at p. 9.) The other case principally relied upon by Eaton, *A-C Co. v. Security Pacific Nat. Bank* (1985) 173 Cal.App.3d 462, also involves trial of an equitable claim of promissory estoppel and constitutes a mere application of the ruling in *C & K Engineering Contractors* to very similar facts. (*Id.* at p. 473.)

IV.

MEASURE OF DAMAGES ISSUES

In various guises and contexts, Eaton raises a number of issues concerning the measure of damages. It asserts that an out-of-pocket damages rule must prevail and that PKL is not entitled to recover any damages based on an "unfair merger" claim since PKL filed its complaint before the merger occurred. It further contends that the

trial court improperly presented the issue of compensatory damages on the two counts in a single combined instruction to the jury. Eaton also contends that reversal is required because PKL's proof varied materially from the pleadings insofar as PKL rested its case on an "unfair merger" claim, which was allegedly unpled and legally impermissible.[9]

Essentially, Eaton's arguments boil down to a question of whether an out-of-pocket measure of damages applies or whether disgorgement of advantage or profits is required.[10] However, the out-of-pocket loss rule as a measure of damages does not apply where a fiduciary relationship exists between the fraudulent and defrauded parties. (*Walsh v. Hooker & Fay* (1963) 212 Cal.App.2d 450, 458.) In *Savage v. Mayer* (1949) 33 Cal.2d 548, the defendant had purchased stock for the plaintiff at $17 but had represented to plaintiff that the price actually paid was $20. The defendant claimed he was entitled to the out-of-pocket measure of loss and, relying on the fact that no value for the stock at the time of the purchase had been shown, claimed that plaintiff was entitled to recover nothing. The Supreme Court held that the defendant was required to disgorge his profits. (*Id.* at pp. 550-551.) The Supreme Court noted "that the principal's right to re-

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[9]In this contention, Eaton rests its argument in part upon the argument that the case is an equitable one which should not have been tried to a jury. This aspect of the argument has previously been discussed in this opinion, *ante,* Part III.

[10]Civil Code section 3343 sets forth an out-of-pocket measure of damages in pertinent part as follows: "(a) One defrauded in the purchase, sale or exchange of property is entitled to recover the difference between the actual value of that with which the defrauded person parted and the actual value of that which he received, together with any additional damage arising from the particular transaction . . . ."

cover does not depend upon any deceit of the agent, but is based upon the duties incident to the agency relationship and upon the fact that all profits resulting from that relationship belong to the principal. Thus, section 3343 of the Civil Code, which provides the measure of damages in a suit based upon fraud in the sale or exchange of property, does not operate to limit a principal's recovery to those damages even though the profits may have been acquired though fraudulent representations to him. [Citations.]" (*Id.* at p. 551.)

Where there is a fraudulent breach of fiduciary duty by the fiduciary, another exception to the statutory out-of-pocket loss rule is recognized. In such instance, the aggrieved party "is entitled to compensation for the full amount of the loss caused by the breach of fiduciary duty. (*Pepitone v. Russo* (1976) 64 C.A.3d 685, 688 . . . .)" (4 Witkin, Summary of Cal. Law (8th ed. 1984 supp.) § 908A, p. 584.)

The disgorgement of profits rule also applies to a majority shareholder who breaches his fiduciary duty to minority shareholders. (*Remillard Brick Co. v. Remillard-Dandini* (1952) 109 Cal.App.2d 405, 417-418.) In *Ward v. Taggart* (1959) 51 Cal.2d 736, the state Supreme Court held that, even in a nonfiduciary situation, the party guilty of fraud, under a quasi-contractual theory, must disgorge to the plaintiff any profits arising out of the fraud. (*Id.* at pp. 741-742.) Finally, the federal Court of Appeals for the Ninth Circuit, in an action under antifraud provisions of securities laws, held that where the defendant's profit from a fraudulent purchase exceeded the plaintiff's out-of-pocket loss, the plaintiff was entitled to recover as damages the defendant's profits. (*Nelson v. Serwold* (9th Cir. 1978) 576 F.2d 1332, 1338.)

On a related issue, Eaton contends that the trial court further compounded its errors relating to damages by instructing the jury on a single measure of damages as to both counts.[11] In support of this contention, Eaton relies on the Supreme Court's decision in *Liodas v. Sahadi* (1977) 19 Cal.3d 278, which held that where a jury is given instructions on two theories of liability, ordinary fraud and fraud or breach of trust by a fiduciary, but is only instructed on the measure of damages applicable to fraud by a fiduciary, the failure to give the requested instruction on measure of damages for ordinary or nonfiduciary fraud, based upon the language of Civil Code section 3343, is prejudicially erroneous, "because the jury [has] no alternative but to apply the broader fiduciary standard ('all the detriment proximately caused thereby') even if it found that the fiduciary relationship had terminated." (*Is.* at pp. 283-284.)

Liodas, however, is readily distinguishable since there is not in the instant case the question which was raised in *Liodas* about when the fiduciary relationship had terminated. Here, both Cutler-Hammer, as majority shareholder, and Macrodata remained fiduciaries to PKL throughout all of the events and activities at issue. Hence, the single instruction on damages for fraud by a fiduciary was both appropriate and required by the evidence.

V.

VARIANCE FROM THE PLEADINGS

Characterizing the presentation at trial of evidence concerning the 1977 merger of Macrodata and Cutler-Hammer as constituting a material variance from the

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[11]The instruction at issue is the court's No. 51, which was a modified and tailored version of BAJI No. 12.57.

complaint pled, Eaton claims that it was entitled to a nonsuit and that the trial court committed reversible error by allowing PKL to recover for a cause not pled in the complaint. We agree with PKL that there was no material variance and that the trial court properly admitted evidence concerning the price paid for the Macrodata stock in the merger.

Months after the complaint in this matter was filed, Cutler-Hammer and Macrodata merged, upon which PKL received $5.48 in value for each Macrodata share it owned. As the jury implicitly found, the true value of Macrodata stock was approximately four times greater. Eaton has conceded that it was for the jury to assess the adequacy of "the value PKL ultimately received for [the Macrodata] stock." However, characterizing PKL's damage allegation as a "drive-down" theory, Eaton contends that, because PKL did not prove that the value of the Macrodata stock was destroyed by Eaton's predecessor's wrongful acts, but rather demonstrated that the value remained high, PKL's proof was at variance with the pleadings. Eaton mischaracterizes the evidence and misreads the language of the complaint.

The complaint does not allege that the defendants merely paid an unfair price for Macrodata stock. Instead, it alleges that the defendants' wrongdoing destroyed the market for the stock, although it also alleges that the defendants' wrongdoing was aimed at acquisition of PKL's stock for a price below its fair value. The evidence presented at the trial by PKL showed that Cutler-Hammer succeeded in destroying the market for PKL's Macrodata shares and was thus able to acquire PKL's shares in the merger at a price below their fair value. Such proof is not inconsistent with the allegations in the

complaint and does not constitute a material variance, as would justify a nonsuit or reversal.

That PKL is entitled to recover damages which accrued after it filed its complaint cannot be successfully contested. Under Civil Code section 3283, "damages may be awarded, in a judicial proceeding, where detriment resulting after the commencement thereof, or certain to result in the future." (See also 4 Witkin, Summary of Cal. Law (8th ed. 1974) Torts, § 847, p. 3141.)

VI.

VALUATION OF THE STOCK

Eaton further contends that the trial court committed reversible error by admitting certain evidence concerning valuation of PKL's Macrodata stock and excluding other evidence proffered by Eaton. Eaton's claim of prejudice and error lacks support in the record and in California case law.

First, Eaton contends that the trial court erroneously permitted PKL to call four expert witnesses (Fingerhood, Anderews, Roberts and Schultz) to give opinion testimony about the value of PKL's Macrodata stock. Eaton seems to contend that only contemporary market data was admissible despite the fact that Cutler-Hammer actions had irrevocably altered the market. Based in part upon citation of authority from other jurisdictions, Eaton contends that the experts' testimony was in large measure improper because it was speculative, based on data not available in 1977 or predicated upon assumed facts which were contrary to the truth.

We reject these assertions for two reasons. First, Eaton continues to rely on appraisal statute case law. Nonetheless, even cases applying appraisal statutes hold that

where, as here, a defendant by its wrongful conduct has destroyed the market in a stock, the price of a few subsequent trades in the stock need not be considered an accurate barometer of value and may be irrelevant in that regard. For example, *Gallois v. West End Chemical Co.* (1960) 185 Cal.App.2d 765 holds that the market price is the appropriate measure only where the "market [is] not distorted by fraud, manipulation, rigging, or unfair conduct of the management vis-a-vis the shareholders . . . ." (*Id.* at pp. 772-773.) The market price measure thus applies only when "the evidence clearly shows that there was an active and informed market for the stock . . . ." (*Id.* at p. 773.)

The second reason is that Eaton's own description of this evidence is misleading. While Eaton contends that Fingerhood based his projection on the post-merger results of the performance of three semiconductor corporations, Fingerhood's 40 percent projection was based on factors in existence in 1977. Eaton argues that no one in the industry, including Fingerhood, predicted in 1977 a 40 percent growth for Macrodata. More accurately, however, Fingerhood testified that he knew of no such projection and made no such estimate himself because he did not study Macrodata during that time period. Fingerhood did, however, study the semiconductor industry in 1977 and specifically testified that during 1977, he had predicted rapid growth for the industry as a whole. At trial, he explained why Macrodata could have been included in those forecasts. He further testified that when adjusted to take into account the recession of 1975 and 1976, his predicted 30 percent growth rate was properly expandable into a 40 percent projection. Thus, it was possible for the jury to be persuaded that Fingerhood's examination of post-merger data was confirmatory of his 1977 projec-

tions inasmuch as Macrodata was includable within the industry forecasts.

As for these and the other discrepancies which Eaton highlights on this appeal, we believe they go to the weight of such evidence rather than its admissibility and that it was well within the jury's province to hear such testimony and assess it. The same may well be said of Eaton's other attacks on the admission or nonadmission of evidence concerning valuation of the Macrodata stock. Nonetheless, we will briefly touch upon each of Eaton's assertions.

Eaton complains of the trial court's exclusion of Macrodata's post-1977 performance results. Even though Eaton had previously during discovery in the case argued that such data was not discoverable as wholly irrelevant, it asserted that the PKL's experts' use of post-merger data in support of its expert projections opened the door to such performance results. Eaton proposed to present such evidence in the form of two documents compiling purchase and cost data and the testimony of the controller of the Macrodata division of Eaton. Eaton couches its argument essentially in the complaint that the jury was permitted to hear plaintiff's experts making "hindsight projections" of optimistic Macrodata prospects in 1977 while the jury was denied testimony concerning the actual post-merger performance of Macrodata.

We conclude that the trial court properly excluded Macrodata's post-merger performance results on the ground of lack of relevance. Eaton is mixing apples and oranges. While both Eaton and the trier of fact might take issue with some of the data upon which PKL's experts relied upon in making their assessment concerning the 1977 value of the Macrodata stock, the presentation of nonexpert testimony as to the subsequent performance of Macrodata was irrelevant. That had noth-

ing to do with the value of the stock at the time of the 1976 and 1977 events at issue here. Nor is there any lack of even-handedness on the part of the trial judge, since clearly he did not prevent Eaton from presenting its own expert witnesses to testify to opinions different from those of PKL's experts based upon similar types of data.

Eaton next contends that under settled law, reversal is required because PKL's experts valued the stock primarily by a "price/earnings" ratio comparison between Macrodata, a company with no active market for its stock, and companies whose stock is actively traded. Although Eaton did object to the testimony of these experts (i.e., Fingerhood and Roberts), it did not make this specific objection at trial and may not, therefore, raise this issue for the first time on appeal. Failure of a party to object at trial to an expert's method of projecting future earnings constitutes a waiver of the right to raise that issue on appeal. (*Rodriguez v. McDonnell Douglas Corp.* (1978) 87 Cal.App.3d 626, 659-660.)

In any event, there are authorities that indicate that where a defendant has destroyed the market for a corporation's stock, measuring a corporation's future earnings power under a future earnings analysis like that applied by PKL's experts is a proper basis for valuing the stock. (*Holmes v. Bateson* (1st Cir. 1978) 583 F.2d 542, 562.)

Eaton also argues that the three companies upon which three of PKL's experts relied as comparable to Macrodata in rendering their opinions (GCA, Computervision and Teradyne) were not in fact comparable, because these companies were more successful than Macrodata. We agree with PKL that the admissibility of the comparables was for the trial court to decide in its sound discretion and that having admitted it, the questions raised by Eaton go only to the weight of such

evidence. (See *City of Ontario v. Kelber* (1972) 24 Cal.App.3d 959, 970 (condemnation of real property).) We find no abuse of the court's discretion in this matter, especially since in a document appended to one of Morgan Stanley's private valuation reports, Morgan Stanley compared Macrodata to GCA, Computervision and Teradyne — the same companies relied on by PKL's experts.

Two additional, related arguments of Eaton are that: (1) the trial court erroneously permitted PKL's experts to testify that Macrodata had what Eaton terms a "peculiar value" to Cutler-Hammer; and (2) the trial court erroneously allowed PKL's experts to consider the expected financial support from Cutler-Hammer in computing the value of Macrodata stock. The contentions are not valid.

PKL's experts considered Macrodata's value to Cutler-Hammer in the context of an acquisition by any company with a high technology division. It also appears to this court that Cutler-Hammer's expressed intentions to financially support Macrodata would have been considered by any investor in 1977 in assessing Macrodata stock. Hence, it was proper for PKL's experts to so consider that factor. As PKL asserts on this appeal, Morgan Stanley stressed in its private valuations the importance of Cutler-Hammer's support of Macrodata as a consequence of the merger activities. Again, it was within the trial court's discretion to permit such evidence.

Eaton next asserts that the trial court improperly allowed PKL's experts to add in a premium for control of Macrodata by Cutler-Hammer in determining the value of Macrodata stock. Eaton cites no California authority for its contention and the authorities it does rely on are statutory appraisal cases. We see no error.

Finally, Eaton contends that the trial court erred by excluding PKL's 1977 financial statement valuing Macrodata shares at $6.25 per share. This exclusion was made pursuant to Evidence Code section 352. Here, there is no prejudicial error. During the cross-examination of Frederic Papert, PKL's president, Eaton was allowed to elicit detailed testimony that in 1977 and other years, PKL listed in its financial statements the value of its Macrodata stock at $6.25. The trial court was evidently concerned that other data on the financial statement might be confusing or prejudicial to PKL. Since the information about which Eaton complains was in fact placed before the jury, there is no prejudice to Eaton and the document itself would have been cumulative.

In summary, concerning the valuation of the Macrodata stock held by PKL, we agree with PKL that Eaton has failed to show specific prejudice concerning admission of valuation evidence. Moreover, since the private Morgan Stanley reports valued Macrodata stock as high as $16.40 per share as of 1977, even without adding premiums for control or merger synergy, there remains substantial evidence aside from the expert opinions which amply sustain the jury's verdict that as of August 1977, Macrodata stock was worth $17.60 per share.[12]

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[12]PKL suggests that 7.4 percent to 7.8 percent should be added as a premium for control or synergism, a proposition with which we need not agree nor disagree except to note that some premium might well be appropriate and thus the trier of fact would be entitled to add some amount to the $16.40 that Morgan Stanley privately reported.

VII.

SUFFICIENCY OF THE EVIDENCE

Viewed in accordance with the customary and well-settled rules of appellate review, substantial evidence supports the jury's verdict. Since the jury returned a general verdict, the judgment must be affirmed if a finding of liability on either one of the two causes of action pled, promissory fraud or breach of fiduciary duty, is supported by substantial evidence and is unaffected by error. (*Khanna v. Microdata Corp.* (1985) 170 Cal.App.3d 250, 258; *McCloud v. Roy Riegels Chemicals* (1971) 20 Cal.App.3d 928, 935-936.)

Even without reaching the breach of fiduciary duty claim, which was based essentially on the false financial statement which understated Macrodata's losses, the cover-up and then the carefully timed disclosure of the true magnitude of the losses, abundant credible evidence supports the promissory fraud claim. The elements of a cause of action for fraudulent misrepresentation, which is related and similar to promissory fraud, are (1) a false representation, (2) an intent to defraud established by, for example, inducing reliance on the false representation, and (3) justifiable reliance on the representation. (*Seeger v. Odell* (1941) 18 Cal.2d 409, 414.) Where the misrepresentation consists of a false promise to perform in the future without any present intention of performing, such a tort constitutes promissory fraud. (4 Witkin, Summary of Cal. Law, *supra,* Torts, § 453.) Proof of intent not to perform a promise may be inferred, as here, from the circumstances. (*Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30-31.)

The evidence established that Macrodata was contractually obligated by the terms of the Investment Agree-

ment to register PKL's shares "as soon as possible," and that from July of 1975 Kant and others at Macrodata falsely represented during the ensuing months that PKL's shares would be promptly registered as PKL had requested in May of 1975. As indicated in a letter written to PKL's attorney on July 17, 1975, Kant promised that Macrodata would take steps to comply with PKL's registration request and asserted that counsel had been instructed to begin preparing a registration statement if some unspecified "alternative" method of satisfying PKL's registration request was not available. On December 2, 1975, at a Macrodata board of directors meeting, a letter was drafted by Kant and sent out over Mow's signature which, in response to PKL's latest demands for registration of its shares, confirmed oral promises made since July that the shares would be registered and once again represented that Macrodata would begin "reasonable efforts" to perfect registration. No one at Macrodata during 1975 instructed its securities counsel to prepare a registration statement or even a so-called no-action letter from the SEC which could constitute an alternative to stock registration. Although in November of 1975 Macrodata researched the possibility of a no-action letter, a draft of such a letter was not sent to PKL until late February of 1976, more than a month after PKL sued to compel the promised stock registration.

Moreover, the evidence supports the conclusion not only that there was a false representation as to the stock registration made with knowledge of the falsity, but that the requisite intent to defraud also existed. In December of 1975, when Macrodata made its last promises to register, Cutler-Hammer, the majority shareholder, wanted to avoid registering PKL's Macrodata shares for as long as possible to pressure PKL into selling its shares. During this same period of time Macrodata and Cutler-Hammer

also knew that Macrodata would incur a large but then yet undetermined loss for 1975 which would negatively affect Cutler-Hammer's earnings goal. Delaying action of PKL's registration demands facilitated the determination whether it would be necessary to minimize Macrodata's loss on Cutler-Hammer's behalf.

After the false accounting had commenced, Macrodata ultimately opted for the no-action letter which conveniently avoided the need for the two Cutler-Hammer agents (Hopkins and Wampler who were the two Culter-Hammer appointees on the Macrodata board of directors) to sign a registration statement which would have contained false financial information and thus exposed themselves and Cutler-Hammer to liability. Indeed, Hopkins specifically told Kant that he would not sign such a registration statement and that any such statement would have to be "carefully reviewed" in light of Thomas' findings. Accordingly, the element of intent to defraud is amply supported by the evidence and reasonable inferences therefrom.

The element of reliance and ensuing damages also exist, as the misrepresentation substantially influenced PKL's course of conduct to its financial detriment.[13] PKL relied by refraining from actively seeking to sell its shares in a private transaction. This conclusion is supported by the testimony of Frederic Papert that although PKL entertained unsolicited discussions with two brokers, PKL "stopped trying to sell its shares" after the May 29, 1975, registration request. Reliance was also established by PKL's delay in filing a lawsuit to compel

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[13]Any remark to the contrary in the prior *Hopkins* appeal is not controlling, since, as previously discussed, collateral estoppel is not a factor.

registration until January of 1976. By January, the false accounting was underway, and PKL's lawsuit came too late to free the restrictions on PKL's Macrodata shares before the fall in the market for the shares. The ensuing fraudulent concealment then prevented PKL from taking steps to stop the filing and publication of Macrodata's false financial statement. Thereafter, the timed orchestration by Cutler-Hammer of the belated public disclosure of the false accounting destroyed the market in Macrodata stock, as indicated by the SEC suspension of trading and the decertification of the financial statement. PKL was thus tied to its Macrodata investment until it exchanged its stock for what was obviously an unfair value in the 1977 forced merger. Accordingly, there was substantial evidence of all the elements of the tort of promissory fraud.

VIII.

EVIDENTIARY RULINGS

We reject Eaton's contention that the trial court improperly allowed PKL to call Dr. Mow as an adverse witness pursuant to Evidence Code section 776. The court did not abuse its clear discretion. That section permits "a person identified with [an adverse] party, . . . [to] be called and examined as if under cross-examination . . . at any time during the presentation of evidence by the party calling the witness." (Evid. Code, § 776, subd. (a).) A witness "is identified with a party if he is: . . . . (2) [a] director, officer, superintendent, member, agent, employee, or managing agent of [the adverse party] . . . ." (Evid. Code, § 776, subd. (d).) Without a doubt, as the president of Macrodata, Dr. Mow fell in that category. Moreover, Eaton could have suffered little harm from the

court's action since it too was allowed to treat Dr. Mow as an adverse witness.

Eaton also is unable to show any prejudice arising out of the trial court's ruling permitting Mow's cross-examination to be delayed for two weeks, and we can find none in the record. In light of the length of this trial and the breadth of examination permitted, the jury's perception of Dr. Mow could not have been influenced by this relatively short hiatus in his testimony. In any event, the trial court permitted the same accommodation as to various defense witnesses.

Similarly, we find no prejudice with regard to the trial court's exclusion of Mow's separate complaint filed in his legal action against Eaton, which Eaton offered to show Mow's bias. The trial court had permitted Eaton to bring out during Mow's examination that Mow had filed a lawsuit against Eaton and others, contending that these defendants had committed fraud and breach of fiduciary duty in connection with Macrodata's accounting records and that Mow had nowhere conceded in that lawsuit that he was involved in the accounting fraud. The trial court excluded the complaint itself as cumulative and we uphold the trial court's ruling, which was well within its discretion. (see *Neumeyer v. Crown Funding Corp.* (1976) 56 Cal.App.3d 178, 185 (disapproved on other grounds *Liodas v. Sahadi, supra*, 19 Cal.3d 278.)

Eaton also contends that the trial court committed prejudicial error by its exclusion of certain evidence during the examination of Joseph Rivlin, a Macrodata employee who had left the company in September 1975. Eaton urges that its attempt to undermine Mow's credibility was improperly frustrated by the court's action and that Rivlin's credibility was unfairly undermined by the trial court's exclusion of Rivlin's statements made in a

declaration from another lawsuit. Most of Rivlin's testimony, as well as the gist of the excluded evidence to which Eaton alludes, concerned allegations that Mow and Macrodata were not controlled by Cutler-Hammer and that Mow, not Cutler-Hammer, was responsible for the deceptive accounting practices at Macrodata. Eaton, however, fails to show that the excluded declaration was relevant in its entirety and our review of the record indicates that the court's rulings excluding various questions and portions of the declaration were proper. These various rulings were made on grounds of hearsay and relevancy and Eaton has failed to show that these rulings were incorrect. In any event, Eaton has suffered no prejudice because Rivlin was permitted to testify as to virtually all the matters about which Eaton now complains.

Eaton also contends that the testimony of PKL's expert witnesses, principally Roberts, was unfair. The testimony about which Eaton complains concerned the expert witnesses' assessment of the Morgan Stanley evaluations. Although some of this testimony was contradicted by defense witnesses, it was nonetheless relevant and admissible. It is within the trial court's sound discretion to determine the competency and qualification of expert witnesses, and such a ruling will not be disturbed on appeal unless a manifest abuse of the discretion is shown. (*Miller v. Los Angeles County Flood Control Dist.* (1973) 8 Cal.3d 689, 701.) The matters upon which the expert witnesses testified were sufficiently beyond common experience so that the experts' opinion could assist the trier of fact. (Evid. Code, § 801, subd. (a).) Regardless of the testimony of Fred Ulrich, the initial Morgan Stanley private report, labeled "confidential," made any subsequent reports by Morgan Stanley questionable.

Likewise, the experience of PKL's expert witnesses, as investment bankers and advisors, permitted the trial court to allow these witnesses to assess the conflict of interest regarding Morgan Stanley's fee arrangement and the nature of its business, giving rise to a question about objectivity in the public valuation of the Macrodata stock. Such testimony was appropriate to assist the jurors on those issues.

Eaton's contention that the trial court abused its discretion in permitting PKL to ask leading questions of its expert witnesses borders on the frivolous. This form of questioning is clearly permissible. Furthermore, the hypothetical questions asked by the PKL attorneys were well within the range of the evidence and were based on theories reasonably deducible from the evidence.

Eaton's further complaint about PKL's use of certain newspaper and magazine articles during its cross-examination of James Allwin, a Morgan Stanley employee, is likewise not well taken. Although selected portions of these documents were read to Allwin, limited instructions were given by the court. On direct examination, over PKL's objection, the witness had been permitted to testify about Morgan Stanley's reputation for accuracy and thoroughness in the investment business. The purpose of the cross-examination inquiry concerning the articles was to probe Allwin's knowledge and understanding of Morgan Stanley's reputation for fairness and accuracy. The direct examination had necessarily opened the door to such cross-examination. (*People v. Hurd* (1970) 5 Cal.App.3d 865, 879-880.)

Lastly, Eaton's claim of unfairness in the cross-examination of Roberts is unfounded. Eaton urges that the trial court unfairly prevented it from using unfavorable "customer comments to impeach the rosy growth projections

[for Macrodata]." These "customer comments" had purportedly been made by certain Macrodata customers and included in a 1976 report on the position of Macrodata in the semi-conductor automatic test equipment industry, a report prepared by the Arthur D. Little Company. The report was one of many reviewed by Roberts in reaching his opinion on the value of Macrodata stock and the trial court did not abuse its discretion in curtailing cross-examination as to statements which were clearly hearsay and lacking in foundation. Moreover, prejudice, if any, was mitigated since, as Eaton concedes, the Arthur D. Little report was in evidence, and Eaton was permitted extensive cross-examination of all of PKL's witnesses.

IX.

JURY INSTRUCTIONS

Contending that the trial court instructed that PKL did not have to prove that Cutler-Hammer caused its injuries, Eaton asserts it was error for the trial court to have given an instruction which it characterizes as a *Summers v. Tice* instruction. (See *Summers v. Tice* (1948) 33 Cal.2d 80.) The contention is without merit. This instruction requires that the jury find that, of two parties, *both* engaged in wrongful conduct toward the plaintiff. In this lawsuit, there clearly were two parties whose conduct was in issue and these were Macrodata and Cutler-Hammer. The instruction properly addressed a legal question concerning the joint liability of the two entities which are now represented by Eaton. The instruction required the jury to conclude that the conduct of each of these two parties was likely to and did cause PKL injury. The instruction required the jury to find that both parties had each engaged in wrongful conduct that resulted in injury to PKL in order for PKL to be awarded damages.

Under this instruction, therefore, the jury must have found that Cutler-Hammer had engaged in wrongful conduct, thereby causing PKL injury.

Moreover, the instructions must be read as a whole, and the jurors were so instructed. Numerous instructions informed the jury that the "wrongful conduct" that PKL was required to prove was fraud and breach of fiduciary duty. It is not possible under these instructions to infer that the jurors thought PKL could recover without proving that Cutler-Hammer had engaged in wrongful conduct and that that particular wrongful conduct resulted in injury to PKL.

Eaton further contends that the jury was erroneously instructed that a fiduciary duty was owed by any majority shareholder to a minority shareholder. Missing, Eaton claims, is an explanation to the jury that such a majority shareholder must exercise its control of the corporation in order to owe such a duty. While the court's instruction uses the terms "controlling" and "majority" stockholder interchangeably, it is clear that the jury was sufficiently advised that it was the exercise of control which spawns the fiduciary duty.[14] When these instructions are taken as

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[14]The court instructed as follows: "A controlling or majority stockholder in a corporation owes a fiduciary duty to the minority stockholders of that corporation. If you find that Cutler-Hammer was a controlling stockholder in Macrodata, or if you find that Cutler-Hammer otherwise controlled Macrodata, then you must also find that Cutler-Hammer owed a fiduciary duty to the minority stockholders of Macrodata."

A related instruction also characterized the fiduciary duty of a majority shareholder in terms of its use of its controlling power: "A majority or controlling shareholder has a duty to use its control in a fair, just and equitable way. A majority stockholder may not cause the corporation to conduct its affairs in a manner injurious to the

a whole, as the jurors were instructed to do, they clearly do not impel the jury toward a finding that Cutler-Hammer was a fiduciary simply and solely because it was Macrodata's majority shareholder. Eaton's remaining contentions about the court's instructions on fiduciary duty are without merit inasmuch as these instructions do not incorrectly set forth the law and were not misleading.

Eaton also contends that the court's instructions on fraud were erroneous. For example, Eaton asserts that the court's instruction on fraudulent concealment was erroneous because it did not make clear that the intent to defraud and the concealment must be directed at the plaintiff in the case.[15] We find no prejudicial error. It is clear from the facts and circumstances of this case that PKL knew nothing about the false accounting at Macrodata and Cutler-Hammer's intention to see that its

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other stockholders. A majority stockholder may not act in disregard of standards of common decency and honesty. A majority stockholder may not use its position for its own benefit and gain, nor may it use its power for personal advantage or to the detriment of other stockholders. Nor can it use its powers for its own aggrandizement, preference or advantage. All acts of the majority stockholder in dealing with minority stockholders must be inherently fair. Any failure to so act constitutes a breach of fiduciary duty by the majority stockholder."

[15]The instruction complained of reads as follows: "A defendant is liable for fraud and deceit if, as to that defendant, the plaintiff meets its burden of proving by a preponderance of the evidence all of the facts necessary to prove the following issues: (1) That the defendant concealed or suppressed a material fact; (2) That the defendant had a duty to disclose the fact; (3) That the defendant intentionally concealed or suppressed the fact with the intent to defraud; (4) That the plaintiff was unaware of the fact and would not have acted as it did if it had known of the concealed or suppressed fact; and (5) That, as a result of the concealment or suppression of fact, the plaintiff sustained damage."

disclosure occurred at a time so propitious that the failure to register Macrodata stock would be rendered a moot proposition. While it may be that defendants' concealment of these facts was aimed at concealment from everyone, such aim and intent certainly encompassed PKL as well as any others. We agree with PKL that it was the only party to whom the concealed facts regarding Macrodata's and Cutler-Hammer's intended response to the registration request could have been material.

Moreover, Eaton's argument to the jury was that Cutler-Hammer had no role in the wrongful conduct and did not conceal such matters from anyone. As PKL correctly points out, had the jury accepted Eaton's defense, the concealment instruction would not have prevented the jury from exonerating Eaton. The same analysis pertains to the intention to defraud portion of the instruction, and we likewise perceive no prejudice accruing to Eaton.

Arguing that no evidence of misrepresentation existed, Eaton further contends that the trial court's instructions on misrepresentation should not have been given. As previously noted, the evidence supported the jury's finding of promissory fraud, and we observe that promissory fraud embodies a form of misrepresentation. "A promise to do something necessarily implies the *intention to perform*, and, where such intention is absent, there is an implied misrepresentation of fact, which is actionable fraud." (4 Witkin, Summary of Cal. Law, *supra,* Torts, § 453 at p. 2717, emphasis in original.) In any event, such misrepresentation instructions at the worst were merely cumulative and do no support any inference that the jury was misled into an erroneous verdict.

Equally unpersuasive are Eaton's arguments that the trial court erred by instructing on the law of aiding and abetting. Eaton does not assert that the instructions were

in and of themselves erroneous; rather, it urges that the court simply had no basis for so instructing the jury. However, we agree that sufficient evidence lay before the jury to permit the court to give these instructions. That evidence concerned the fact that Macrodata employee Dennis Eversole, who actually prepared the false Macrodata accounting, was pressured by Cutler-Hammer's Thomas to so act. While Eaton spotlights evidence in the record indicating that Thomas did not so pressure Eversole, the evidence as a whole is susceptible of a different view. Thus, the court did not err.

The trial court was also not required to instruct on estoppel. No evidence supports Eaton's assertion that PKL led Eaton's predecessors to believe that PKL in any way abandoned its request for registration of stock. Rather, the record indicates that PKL consistently informed the defendants of its desire for registration, and there is no evidence in the record indicating PKL concealed such desire or represented that that desire had abated.

Eaton's contention that the trial court should have instructed on mitigation also fails for two reasons. First, this alleged evidence amounts to no more than a claim that PKL should have accepted Cutler-Hammer's offer to buy at an unfair price. Second, the record shows that Cutler-Hammer's last offer to purchase was made in November 1975, prior to subsequent and additional false promises.

In a related contention, Eaton argues that the trial court improperly refused Eaton's request to delay closing argument until the instructions were finalized and then changed the jury instructions subsequent to argument. The record indicates that after substantial discussion of the instructions submitted by the plaintiff, the court near

the end of the day on a Thursday suggested to counsel that it might be able to convene for further discussions the next afternoon but that the court might be "tied up" if a morning conference did not conclude. At that point, defense counsel stated: "Can we call them [i.e., the jurors] and have them come in the next day [i.e., Tuesday] or —" Plaintiff's counsel then asked if the attorneys had "enough of an idea what instructions are going to be given so that we can work on argument?" The court replied, "I think you do." Plaintiff's counsel also suggested that counsel could address the instructions further "early Monday morning" prior to the jurors' arrival. Defense counsel stated nothing further relating to putting off the commencement of argument to the jurors.

Subsequently, the court devoted the entirety of the Friday afternoon and a substantial portion of the Monday morning to further discussion of the instructions. Eaton points to no place in the record as to Friday or Monday when counsel requested further time to perpetuate its discussion of the instructions. Thus, Eaton's contention that it made a specific request for delay in closing argument is unsupported by this record. Moreover, even if we assume the Thursday offhand remark of defense counsel constitutes a request, that request was made in the context of the possibility that no time would be available on Friday for discussion. That contingency did not arise.

The record clearly indicates that Eaton's counsel were aware that the trial court's rulings as to the misrepresentation and concealment instructions were tentative and that the court would be giving further consideration to such. PKL's renewed request of the trial court to give these instructions occurred prior to Eaton concluding its closing argument. Likewise, PKL's request of the trial court to modify the jury instructions on promissory fraud

to contain a reference to a promise made in 1975 was made before Eaton concluded its argument. The court granted this latter request prior to Eaton resuming its closing argument. If, during argument, issues are raised "which have not been covered by instructions given or refused, the court may, on request of counsel, give additional instructions on the subject matter thereof." (Code Civ. Proc., § 607, subd. (a).)

The case of *Gotcher v. Metcalf* (1970) 6 Cal.App.3d 96, relied upon by Eaton, is distinguishable. There, the trial court was confused about the instructions and failed to inform the attorneys about its uncertainty. The attorneys, believing the court had settled on the instructions and unaware of the uncertainty, conducted the argument to their complete detriment. The parties here, in contrast, certainly knew that the trial court had not settled on all of the instructions and were not misled into faulty arguments or incautious statements. Although Eaton argues that its counsel had no opportunity to address the misrepresentation and concealment instructions, Eaton fails to show what arguments it set forth which were undermined by the court's change of heart. It also fails to suggest what arguments it could have set forth to counteract any adverse effect of these instructions. Finally, it does not appear that any further delay in commencing jury argument would have changed the circumstances here since it was jury argument itself which stimulated the trial court to make its final instructional alterations.

All other claims of instructional error are resolved adversely to Eaton in light of our resolution of other issues in this case.

X.

MISCONDUCT OF COURT AND COUNSEL

Eaton contends that the trial court committed misconduct in various forms. Eaton claims that it was severely prejudiced by the trial court's adversarial examination of witnesses, its double standard evidentiary rulings and disparate treatment, and its disparagement and lecturing of defense counsel. We initially note in passing that in any jury trial of significant length, such as the instant one, where the stakes are high, it is quite easy to pick about in the record and find multiple instances where a trial judge has been forced to keep the attorneys in line in order to maintain control of the proceedings. And, it would be most unusual to find in such circumstances a trial judge who totally refrained from asking questions of witnesses or who did not admonish counsel in strong terms on more than one occaison. In these respects, this is not an unusual case, nor is it one in which the trial judge acted impartially and prejudicially toward the losing party. We have examined carefully the record, including Eaton's very lengthly excerpts in its appendix to its opening brief. We are wholly unpersuaded that the trial judge in any way abdicated his responsibilities to ensure a fair trial.

It was only on rare occasions during this six-month trial that the trial judge permitted himself to ask questoins of witnesses. On most of these occasions, his purpose was obviously that of clarifying or assisting counsel, including defense counsel. It may not be challanged that the trial court has the right to so act. Evidence Code

section 775 permits the trial court to examine witnesses.[16] On more that one occasion, the trial court in fact interrupted when defense counsel was having difficulty asking a proper question so as to obtain an admissible answer. On those occasions, the trial court intervened to ask the question in such a manner as to elicit the very answers Eaton was seeking. On least two of these occasions, plaintiff's motions to strike the ensuing answers were overruled by the trial court. Thus, we have no difficulty in finding that the trial court's occasional questioning of a witness was nonadversarial and in no way sent a message to the jurors on how they should decide the case.

As to Eaton's claim of double standard rulings and disparate treatment, such claim is clearly sour grapes. Moreover, at times defense counsel adopted the tactic of repeatedly asking improper questions over previously sustained objections in a bulldogged attempt to obtain the admission of evidence which the court had already ruled inadmissible. Such situations led to repeated plaintiff's objections followed by the court's sustaining of all of these. We have examined the testimony of the witnesses which Eaton's brief highlights and find that without exception, Eaton was permitted to examine its witnesses in broad fashion in such a way as to inevitably place before the jury all matters of relevance. It was when Eaton sought to elicit speculative and irrelevant material that Eaton's counsel displayed frustration with the trial judge, who, with considerable patience, maintained his control of this complex matter.

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[16]Evidence Code section 775 provides as follows: "The court, on its own motion or on the motion of any party, may call witnesses and interrogate them . . . ."

Moreover, the trial court did instruct the jury, in accordance with Eaton's request, that nothing the court said during trial was intended to suggest how the jury should decide the issue and that the jury should disregard any prior statement by the court that seemed to indicate otherwise.[17] Although we disagree that the trial court disparaged the defense, we believe this instruction eliminated any harm that possibly could have been engendered by any act of the trial judge. (*Fogo v. Cutter Laboratories, Inc.* (1977) 68 Cal.App.3d 744, 756.)

Finally, we cannot concur with Eaton's claim that the trial court prejudged the case. In ruling on the evidence and controlling the court procedures, a trial judge clearly is permitted to comment on the credibility of witnesses and offer its opinions on the strength or weakness of evidence. (See *Clark v. Laughlin* (1977) 68 Cal.App.3d 506; *Schnear v. Boldrey* (1971) 22 Cal.App.3d 478.) In the instant case, of course, the trial court was not unaware of the fact that a previous jury had discounted Eaton's evidence and had found in favor of the plaintiff. Almost all the comments of the trial judge cited by Eaton on this issue appear to have been made with a view toward instilling in defense counsel a more realistic view of its situation in the trial and the role of its evidence or as merely an attempt to clarify the relevancy of certain evidence. The court did not close its mind about the defense case nor unfairly restrict Eaton's presentation of evidence.

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[17]This instruction was BAJI No. 15.20: "I have not intended by anything I have said or done, or by any questions that I may have asked, to intimate or suggest how you should decide any questions of fact submitted to you, or that I believe or disbelieve any witness. [¶] If anything I have done or said has seemed to so indicate, you will disregard it and form your own opinion."

In such a long, difficult and hard-fought case as the instant one, tension between counsel and between counsel and the court is likely to arise at times, along with an occasional spirit of noncooperation. It is the trial court's obligation to work through those situations, while maintaining its hand at the helm, so as to afford all parties ample opportunity to fairly present their evidence and arguments. (See *Matter of Yagman* (9th Cir. 1986) 796 F.2d 1165, 1178.) Eaton received a fair and complete opportunity to present its evidence and arguments in this matter.

We are also unable to sustain Eaton's claim that PKL counsel engaged in prejudicial misconduct. Again setting forth a lengthy list both in its brief and in an appendix, Eaton contends that plaintiff's counsel misrepresented the evidence on numerous occasions both in asking questions and arguing the case before the jury. We do not propose to analyze each instance individually. Rather, after an extensive examination of each of Eaton's citations, we observe that what Eaton characterizes as misrepresentations are merely instances where PKL's counsel's description of the evidence and its inferences predictably differs from the views expressed by Eaton's counsel. The fact that counsel for opposing sides ascribe different meanings and significance to the evidence does not mean that either counsel has engaged in misconduct or misrepresentation.

For example, Eaton asserts that the trial court should not have permitted PKL's counsel to state that Henry Pollard, Macrodata's securities counsel, took orders from Hopkins of Cutler-Hammer rather than from Macrodata's Kant. But a Hopkins memo of September 18, 1974, states that Hopkins told Kant, who, Eaton concedes, directed Pollard, to delay the registration of PKL's Macrodata

stock. Clearly, Hopkins was the superior in the chain of command. Also, Hopkins was the person at Cutler-Hammer to whom Pollard went for information. Thus, it was not inappropriate for PKL's counsel to maintain that the orders came from Hopkins.

We also find no prejudice accruing from what Eaton characterizes as false accusations concerning tampering with or concealing documents. The fact of the matter is that there were certain documents originating within the defendant corporations which were either inaccurate or incomplete in some respect. PKL properly commented and questioned those documents. While PKL's counsel certainly raised questions about those documents, most of these went toward the issue of authenticity and completeness. Counsel did not attempt to argue that defense counsel or Eaton's agents had tempered with or concealed the evidence.

One lengthy document, a report by the Arthur D. Little Company, on which Eaton relied to attempt to prove that Macrodata had a low 1977 value was missing a page which PKL considered critical. In argument, PKL's counsel stated that the page had been missing since "day one." Counsel also stated, "We got it from Cutler-Hammer" and further observed that "Nobody has ever found it. I don't know what it says." Eaton's counsel interjected an objection to the argument, stating: "There's no evidence. As a matter of fact, I think the evidence is [PKL's counsel] got that from Mow. . . ." Eaton did not object to the comments of PKL's counsel on the ground of misconduct and, in any event, counsel proceeded in argument on the assumption that the document had been obtained from Mow.

Counsel also went on to note that the author of the document in question had been produced as a witness in

the courtroom by Eaton, that he had brought no files to the courtroom with him and that neither at that time nor during his pretrial deposition had he produced the missing page. In a convoluted argument with respect to the assertion of misconduct, Eaton then claims it was precluded from presenting relevant evidence in its examination of that witness. Our examination of the testimony does not bear out that assertion. Defense counsel was permitted to ask questions concerning procedures underlying the preparation of that report and was not prevented from presenting an explanation for the missing page, even assuming its loss might be attributable to inadvertence rather than to a failure of discovery.

As to Eaton's contention that PKL's counsel engaged in misconduct by improper appeal to the jurors' social, emotional, and economic prejudices, we note that, for the most part as to each incident cited, Eaton either failed to object or objected on other grounds. Failure to object in the trial court on the specific ground raised on appeal waives any error in connection with a claim of misconduct. "Generally a claim of misconduct is entitled to no consideration on appeal unless the record shows a timely and proper objection and a request that the jury be admonished." (*Horn v. Atchison T. & S.F. Ry. Co.* (1964) 61 Cal.2d 602, 610.)

XI.

CLAIM OF EXCESSIVE DAMAGES

A. Punitive Damages

Contrary to Eaton's claim, punitive damages may be assessed against it even though it is merely the successor corporation and is distinct from the predecessor corporation, Cutler-Hammer, which was initially implicated in the

wrongdoing. As indicated in Corporations Code section 1170, subdivisions (a) and (c), in a statutory merger, the surviving corporation such as Eaton assumes all of the liabilities of each corporation which is a party to the merger.[18] Statutory exemptions from punitive damages in other unrelated contexts are inapplicable here. (See, e.g., Civ. Code, § 3294.)

In *Moe v. Transamerica Title Ins. Co.* (1971) 21 Cal.App.3d 289, the court considered the issue of successor liability for punitive damages, relied upon the relevant Corporations Code provision which was the substantially similar predecessor to section 1107, and concluded that where one corporation was "taken over" (*id.* at p. 303) by another, there was "nothing in the least improper in the award of punitive damage running jointly against [the original corporation] which continued to exist for the purpose of tort liability, and [the successor corporation], which succeeded to the tort liability of [the original corporation]. Punitive damages are a portion of such tort liability." (*Id.* at p. 305.) To the extent that *In re Related Asbestos Cases* (N.D. Cal. 1983) 566 F.Supp. 818 holds to the contrary, we follow the approach in *Marks v. Minnesota Mining & Manufacturing Co.* (1986) 187 Cal.App.3d 1429, 1434-1435, 1438, which specifically disagreed with

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[18]Corporations Code section 1107 provides, in pertinent part, as follows: "(a) Upon merger pursuant to this chapter the separate existence of the disappearing corporations ceases and the surviving corporation shall succeed, without other transfer, to all the rights and property of each of the disappearing corporations and shall be subject to all the debts and liabilities of each in the same manner as if the surviving corporation had itself incurred them. [¶] . . . [¶] (c) Any action or proceeding pending by or against any disappearing corporation may be prosecuted to judgment, which shall bind the surviving corporation, or the surviving corporation may be proceeded against or substituted in its place."

In re Related Asbestos Cases and adhered to the rule in *Moe* that punitive damages can be assessed against a corporate successor for the actions of a predecessor corporation pursuant to Corporations Code section 1107.[19]

Nor were the punitive damages award of $15,000,000 "so palpably excessive or grossly disproportionate as to raise a presumption they resulted from passion or prejudice." (*Burnett v. National Enquirer, Inc.* (1983) 144 Cal.App.3d 991, 1011.) Although no mathematical formula exists for calculating punitive damages, several factors have been used to evaluate the propriety of an award of punitive damages which involves "a fluid process of adding or subtracting depending on the nature of the acts and the effect on the parties and the worth of the defendants." (*Walker v. Signal Companies, Inc.* (1978) 84 Cal.App.3d 982, 998; see *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc.* (1984) 155 Cal.App.3d 381, 388, 390.) The punitive damages awarded here were not excessive in view of (1) the reprehensible and long-term nature of Cutler-Hammer's fraudulent scheme and machinations to take over macrodata through an unfair merger at the expense of Macrodata's minority shareholder, PKL (see *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 928), (2) the substantial actual damages of approximately $2,600,000 which resulted in only a 5.7 ratio of punitive to compensatory damages (see *Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co.* (1987) 189 Cal.App.3d

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[19]We also note that although not determinative of the issue, by the terms of the merger agreement itself, Eaton, as the surviving corporation, expressly assumed all of Cutler-Hammer's "debts, liabilities, obligations and duties [as if they] had been incurred or contracted by [Eaton]." At the time of the merger in 1978, Eaton was made aware of PKL's lawsuit which was described in the contingent liabilities section of Cutler-Hammer's 1978 annual report.

1072, 1097-1098) and (3) Cutler-Hammer's wealth as measured by its "net worth at the time of trial" (*Zhadan v. Downtown Los Angeles Motor Distributors, Inc.* (1979) 100 Cal.App.3d 821, 839; see *Devlin, supra,* 155 Cal.App.3d at p. 391).

Regarding the latter factor of the defendant's wealth, the punitive damage award was 10 percent of Cutler-Hammer's net worth in 1977, the year Eaton would use to measure wealth, and an apparently somewhat lower percentage of Cutler-Hammer's 1978 net worth, as alleged on appeal by PKL, resulting in percentages well within the generally accepted parameters for punitive damages. (See, e.g., *Goshgarian v. George* (1984) 161 Cal.App.3d 1214, 1228 (10% deemed "reasonable"); *Devlin, supra,* 155 Cal.App.3d at pp. 391-392 (17.5% upheld); *Zhadan, supra,* 100 Cal.App.3d at p. 835 (6.58% upheld).) Moreover, Eaton's reliance on cases such as *Pistorius v. Prudential Insurance Co.* (1981) 123 Cal.App.3d 541, 555, which merely observed that the critical factor in cases which have found excessive punitive damages was often an award which constituted a disproportionate percentage of the defendant's income or net worth, does not justify Eaton's assertion that punitive damages must pass muster under both an income and a net worth analysis.

Accordingly, under the circumstances here, the award of punitive damages was appropriately large enough to punish and deter and not so grossly disproportionate as to raise a presumption that it was the result of passion or prejudice. (See *Neal v. Farmers Ins. Exchange, supra,* 21 Cal.3d at p. 928.) We also note that the jury's award was scrutinized by the trial judge on a motion for a new trial. Although the trial court's determination that the award was reasonable is not binding on this court, it is to be accorded great weight. (*Bertero v. National General Corp.*

(1974) 13 Cal.3d 43, 64; *Chodos v. Insurance Co. of North America* (1981) 126 Cal.App.3d 86, 103.) We cannot conclude that the trial court erred, and we deem the award of punitive damages justified.

B. Actual Damages

Eaton further asserts that in computing the actual or compensatory damages, the jury made an error in arithmetic and improperly based its award on a misunderstanding regarding the amount received by PKL in the merger. However, the jury properly calculated compensatory damages.

The jury obviously determined the proper stock-for-stock exchange ratio as of August 1977 to be .66 Cutler-Hammer shares for each Macrodata share, rather than the .165 exchange ratio which had been used, and then properly determined PKL's damages as of January 18, 1978, the actual date on which the merger was completed. The compensatory damages award of $2,633,599 was correctly calculated as being equal to the $3,511,432 value of the Cutler-Hammer shares PKL should have received on January 18, 1978, if the proper .66 exchange ratio had been used, minus the $877,833 value of the Cutler-Hammer shares that PKL actually received by virtue of the improper .165 exchange ratio.

Eaton has apparently erroneously focused on the calculation of damages as of January 1978, when the merger actually occurred, rather than the calculation necessary to arrive at the stock-for-stock exchange ratio had Macrodata stock been fairly valued as of August 1977, the date established by Cutler-Hammer for determining the exchange ratio. Once the ratio was set as of August 1977, PKL was entitled to share in the appreciation of the market price of Cutler-Hammer shares between August

1977 and January 1978. Accordingly, therre were no so-called "mathematical mistakes."

DISPOSITION

The judgment is affirmed. Costs on appeal are awarded to plaintiff.

NOT TO BE PUBLISHED.

BOREN, J.

We concur:

ASHBY, Acting P.J. KENNARD, J.

Los Angeles Superior Court Case No. C185010

ALFRED L. MARGOLIS, JUDGE

McCutchen, Black, Verleger & Shea, Howard J. Privett, Ralph Zarefsky and Louis A. Karasik for Defendant and Appellant.

Rosenfeld, Meyer & Susman, Stephen A. Kroft, Robert M. Dudnik, Robert H. Rotstein and Karen E. Garver for Plaintiff and Respondent.

APPENDIX B

NOT TO BE PUBLISHED

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION FIVE

PKL COMPANIES, INC.,
Plaintiff and Respondent,

v.

EATON CORPORATION,
Defendant and Appellant.

2d Civil No B010958
(Super. Ct. No. C185010)

THE COURT:

It is ordered that the opinion filed herein on July 18, 1988, be modified in the following particulars:

On page 2, footnote 1, the punitive damages figure was incorrectly listed as "17,500,00." The amount should be $17,500,000.

APPENDIX C

OFFICE OF THE CLERK
COURT OF APPEAL
STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT
ROBERT N. WILSON, CLERK

DIVISION: 5 DATE: 08/16/88

McCutchen, Black, Verleger & Shea
Louis A. Karasik
600 Wilshire Blvd.
Los Angeles, CA. 90017

RE: Pkl Companies, Inc.
vs.
Eaton Corporation
2 Civil B010958
Los Angeles NO. C185010

THE COURT:

Petition for rehearing is denied.

APPENDIX D

ORDER DENYING REVIEW

AFTER JUDGMENT BY THE COURT OF APPEAL

SUPREME COURT

FILED NOVEMBER 16, 1988

Clerk

Deputy

2nd District, Division 5, No. B010958
S006968

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

IN BANK

P K L COMPANIES INC., Respondent,

v.

EATON CORP., Appellant.

Appellant's petition for review DENIED.

MOSK

Acting Chief Justice

APPENDIX E

California Corporation Code § 1107. Cessation of existence of disappearing corporation and surviving corporations: Rights of creditors and liens on property: Pending actions

(a) Upon merger pursuant to this chapter the separate existence of the disappearing corporations ceases and the surviving corporation shall succeed, without other transfer, to all the rights and property of each of the disappearing corporations and shall be subject to all the debts and liabilities of each in the same manner as if the surviving corporation had itself incurred them.

(b) All rights of creditors and all liens upon the property of each of the constituent corporations shall be preserved unimpaired, provided that such liens upon property of a disappearing corporation shall be limited to the property affected thereby immediately prior to the time the merger is effective.

(c) Any action or proceeding pending by or against any disappearing corporation may be prosecuted to judgment, which shall bind the surviving corporation, or the surviving corporation may be proceeded against or substituted in its place.

Added Stats 1975 ch 682 § 7, effective January 1, 1977.

California Civil Code § 3294.*

(a) In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in

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*The statute is reproduced here as applied by the Court of Appeal in denying Eaton's appeal. The statute was amended in 1987, adding provisions which are not at issue in this case.

addition to the actual damages, may receover damages for the sake of example and by way of punishing the defendant.

(b) An employer shall not be liable for damages pursuant to subdivision (a), based upon acts of an employee of the employer, unless the employer had advance knowledge of the unfitness of the employee and employed him or her with a conscious disregard of the rights or safety of others or authorized or ratified the wrongful conduct for which the damages are awarded or was personally guilty of oppression, fraud, or malice. With respect to a corporate employer, the advance knowledge and conscious disregard, authorization, ratification or act of oppression, fraud, or malice must be on the part of an officer, director, or managing agent of the corporation.

(c) As used in this section, the following definitions shall apply:

(1) "Malice" means conduct which is intended by the defendant to cause injury to the plaintiff or conduct which is carried on by the defendant with a conscious disregard of the rights or safety of others.

(2) "Oppression" means subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights.

(3) "Fraud" means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.

(d) Damages may be recovered pursuant to this section in an action pursuant to Section 377 of the Code of Civil Procedure or Section 573 of the Probate Code based upon a death which resulted from a homicide for which

the defendant has been convicted of a felony, whether or not the decedent died instantly or survived the fatal injury for some period of time. The procedures for joinder and consolidation contained in Section 377 of the Code of Civil Procedure shall apply to prevent multiple recoveries of punitive or exemplary damages based upon the same wrongful act.

Enacted 1872; Amended Stats 1905 ch 463 § 1 p 621; Stats 1980 ch 1242 § 1; Stats 1982 ch 174 § 1; Stats 1983 ch 408 § 1.

Prior Law: Field's Draft NY CC § 1839.

Amendments:

1905 Amendment: Substituted (1) "In an" for "In any" at the beginning of the section; (2) "express or implied, the plaintiff" for "actual or presumed, the jury"; and (3) "recover" for "give" after "may".

1980 Amendment: (1) Designated the former section to be subd (a); (2) deleted "express or implied," after "or malice," in subd (a); and (3) added subds (b) and (c).

1982 Amendment: Substituted "and conscious disregard, authorization, ratification" for ", ratification," after "advance knowledge" in subd (b).

1983 Amendment; Added subd (d)

Note — Stats 1980 ch 1242 also provides: § 3. If any provision of this act or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect any other provision or application of this act which can be given effect without the invalid provision or application, and to this end, the provisions of this act are severable.

Note 2 — Stats 1983 ch 408 provides: SEC. 2. This act is part of the Crime Victim Restitution Program of 1983 in that it expands the ability of survivors of homicide victims to obtain punitive damages from convicted criminals.

APPENDIX F

SUPERIOR COURT
OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

FILED
AUG 31, 1983
JOHN J. CORCORAN COUNTY CLERK
BY L. KOBAYASHI, Deputy

Dept. No. 40

No. C185010

Alfred L. Margolis
Judge Presiding.

Instruction No. 2
[Given as Requested by PKL]

Macrodata and Cutler-Hammer were originally sued as defendants in this matter. During the pendency of this action Macrodata was merged into Cutler-Hammer and Cutler-Hammer was merged into Eaton. Because of these mergers, Eaton, as the surviving corporation, is subject to all debts and liabilities of Macrodata and Cutler-Hammer in the same manner as if Eaton had itself incurred them. Therefore, if you find that Macrodata and/or Cutler-Hammer is liable to the plaintiff, you shall find that Eaton is liable to the plaintiff to the same extent.

Special Instruction No. 41
[Given as Requested by PKL]

If you find that plaintiff suffered damage as a proximate result of the conduct of a defendant on which you base a finding of liability, you may then consider whether you should award punitive or exemplary damages against the defendant for the sake of example and by way of

punishment. You may in your discretion award such damages, if, but only if, you find by a preponderance of the evidence that said defendant was guilty of fraud or malice in the conduct on which you base your finding of liability.

"Malice" means conduct which is carried on by the defendant with a conscious disregard for the rights of others.

"Fraud" means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.

The law provides no fixed standards as to the amount of such punitive damages, but leaves the amount to the jury's sound discretion, exercised without passion or prejudice.

In arriving at any award of punitive damages, you are to consider the following:

(1) The reprehensibility of the conduct of the defendant,

(2) The amount of punitive damages which will have a deterrent effect on the defendant in the light of defendant's financial condition,

(3) That the punitive damages must bear a reasonable relation to the actual damages.

B.A.J.I. 14.71 (1981 Revision)

Special Instruction No. 42
[Given as Requested by PKL]

In determining the amount of punitive damages, if any, you should consider the following elements:

(1) The wealth of the defendant — the wealthier the defendant the larger the award of punitive damages needs to be in order to accomplish the statutory objective of punishing the defendant's wrongdoing;

(2) The particular nature of the defendant's acts in the light of the whole record — the more reprehensible the acts the greater the appropriate punishment.

(3) The amount of actual damages — punitive damages must bear a reasonable relationship to actual damages.

B.A.J.I. 14.71 as modified

APPENDIX G

2ND CIVIL NO.
B010958

In the Supreme Court
OF THE
State of California

THE PKL COMPANIES, INC.,
Plaintiff and Respondent

VS.

EATON CORPORATION,
Defendant and Appellant

PETITION FOR REVIEW

**After A Decision By the Court of Appeal,
Second Appellate District,
Division Five**

HOWARD J. PRIVETT
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2ND CIVIL NO.
B010958

In the Supreme Court
OF THE
State of California

THE PKL COMPANIES, INC.,
Plaintiff and Respondent,
VS.
EATON CORPORATION,
Defendant and Appellant.

PETITION FOR REVIEW

To the Honorable Malcolm M. Lucas, Chief Justice of California, and to the Honorable Associate Justices of the Supreme Court of the State of California:

Petitioner Eaton Corporation ("Eaton"), defendant below, respectfully petitions this Court for review of the decision of the Court of Appeal, Second Appellate District, Division Five, on July 18, 1988, which affirmed a jury award of $2,600,000 compensatory damages and a staggering $15,000,000 punitive damages. A copy of the Court of Appeal's unpublished decision ("*Eaton II*") is attached as Appendix A to this petition. This unprecedented award arose in a commercial dispute between sophisticated parties over the price of stock in a corporate merger. The issues raised by this case and the maximal exemplary damages award present inportant questions of law which have far-reaching consequences for both litigants and the bar.

ISSUES PRESENTED FOR REVIEW

Plaintiff below, the PKL Companies, Inc. ("PKL"), was the minority shareholder in Macrodata Corporation. PKL's basic claim was that Cutler-Hammer, Inc., the majority shareholder of Macrodata, breached a duty owed to the minority by engaging in misconduct in 1975 and 1976 which negatively affected the value of Macrodata stock, and by then acquiring Macrodata through a statutory merger in November 1977 at a price below fair value. Eaton is accused of nothing: it appears only as the successor-in-interest to Cutler-Hammer, which Eaton acquired over two years after PKL filed its Complaint.

The issues presented for review in this petition are as follows:

1. May punitive damages of $15,000,000 be imposed on a totally innocent corporate successor for the conduct of a predecessor which has completely ceased to exist, especially where no separate identity of the predecessor remains in the successor?

This issue calls for resolution by this Court of confusion in the reported decisions concerning the application of Cal. Corp Code § 1107 to punitive damages, and a determination whether the public policy that punitive damages are improper unless assessed against the party actually responsible for the wrong applies equally to successor corporations.

2. Where a minority shareholder has profited more than $1.2 million on its investment, is a $15,000,000 punitive damage windfall, constituting 10% of the wrongdoer's net worh and 62% of its net income, excessive under common law principles and California statutes?

This issue calls for this Court to determine whether *Egan v. Mutual of Omaha Ins. Co.,* 24 Cal.3d 809, 169

Cal.Rptr. 691 (1979), which held that a punitive award constituting 58% of the wrongdoer's net income was "excessive as a matter of law" (24 Cal.3d at 824), is controlling law in this state and prohibits a punitive award that is three times greater than any prior punitive award affirmed in a published opinion by the courts of California.

3. Where a minority shareholder deliberately waives its statutory right under Cal. Corp. Code § 1300 *et. seq.* to Court supervised appraisal of the value of its shares in a merger, may the minority nonetheless pursue a jury trial to dispute the merger price?

This question calls for this Court to determine an issue left for future decision in *Steinberg v. Amplica, Inc.*, 42 Cal.3d 1198, 233 Cal.Rptr. 249 (1986): is the appraisal remedy, found by this Court in *Steinberg* to be both the adequate and exclusive remedy under Cal. Corp. Code § 1312(a) for disputes over fair value in a merger, rendered optional by the limited exception to exclusivity found in § 1312(b); i.e., does the exception permit litigation over the fair value of stock in a "common control" merger and claims for punitive damages?

4. Are minority shareholders entitled to jury trials for resolution of the equitable restrictions imposed on majority shareholders under *Jones v. Ahmanson,* 1 Cal.3d 93, 81 Cal.Rptr. 592 (1969)?

This question calls for this Court to decide if its holding in *C & K Engineering Contractors v. Amber Steel Co.,* 23 Cal.3d 1, 151 Cal.Rptr. 323 (1978) that there is no right to jury trial for a claim which would not exist but for the application of equitable principles, applies to the cause of action for breach of majority shareholder duty established by *Jones.*

5. If jury trials are to be had for breach of majority shareholder duty under *Jones,* what are the elements of the cause of action to be submitted to the jury?

May a jury be instructed to "presume fraud" if the majority has some "advantage" over the minority? Is the defendant entitled to instructions which define "advantage" and identify the several plain advantages possessed by the majority which are incompetent, as a matter of law, to show breach of duty under *Jones?*

6. Where the appellate court exonerates an employee/defendant of wrongdoing and makes findings of fact about both his conduct and that of the plaintiff, may the appellate court in a subsequent appeal in the same action hold the employer/defendant liable for conduct by the employee which the prior decision concluded did not occur, and make other findings of fact expressly contrary to the prior appellate decision?

This issue presents questions of the jurisdiction of trial courts under Cal. Code Civ. Proc. § 916(a) to adjudicate matters that have been appealed, and calls for this Court to reaffirm the principle of *Southern Pacific Railway Co. v. Los Angeles,* 5 Cal.2d 545, 55 P.2d 847 (1936), that it is impermissible for two appellate courts to "reach [ ] diametrically opposite conclusions as to the legal effect of the same occurrence, where the essential same facts are similarly presented" (5 Cal.2d at 548).

STATEMENT OF THE CASE

A. The Facts

Although the facts are highly disputed, we present them as found by the Court of Appeal, highlighting those facts bearing on the legal issues presented for this Court.[1]

Respondent PKL was a minority shareholder holding unregistered stock in Macrodata Corporation. The Court of Appeal found that PKL had a contractual right to have its shares registered by Macrodata, and that promises by Macrodata personnel in 1975 and 1976 that PKL's stock would be registered were broken. The Court of Appeal found that PKL relied on these promises by failing to actively seek buyers for its shares and by delaying legal action to compel registration of its shares until it was no longer practical. The Court also found that a Cutler-Hammer employee, David Hopkins, encouraged Macrodata to avoid fulfilling its registration obligations to further Cutler-Hammer's pursuit of a scheme to purchase PKL's shares at a lower than fair value.

The Court of Appeal found that Cutler-Hammer decided in late 1974 to acquire Macrodata and took actions thereafter to permit this acquisition at an unfairly low price. Cutler-Hammer first purchased stock in Macrodata in early 1974 and became majority shareholder in May 1975 upon further purchases. The Court of Appeal found that Cutler-Hammer artificially depressed the market for

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[1]Citations to the Clerk's Transcript on Appeal are abbreviated "C.T.," and to the Reporter's Transcript "R.T." The volume of the transcript cited precedes the citation, and the page number follows. The last (fifteenth) volume of the C.T. is cited as "Supp. C.T." (Supplemental C.T.).

Macrodata stock by making purchases in private transactions that were unreported.

When Cutler-Hammer became majority shareholder, it was required to consolidate Macrodata's financial statement with its own. The Court of Appeal found that Cutler-Hammer sent an internal auditor to Macrodata in late 1975 who attempted to pressure Macrodata to understate its losses so that Cutler-Hammer could report higher earnings per share in the consolidated financial statement. The Court of Appeal found that Macrodata employees were pressured into committing accounting falsifications which understated Macrodata's loss. The Court also found that the auditor discovered other irregularities in Macrodata's books which indicated an overstatement of inventory, but failed to disclose these findings to Macrodata's outside auditors, who then certified the accuracy of Macrodata's 1975 financial statement.

In April 1976, Macrodata's 1975 financial statement was made public, showing losses of $2.28 million. The Court of Appeal found that Cutler-Hammer concealed knowledge that the actual losses were much higher, then orchestrated the announcement of the real losses in such a way as to deflect criticism away from itself. Following a meeting of the Macrodata Board of Directors in April 1976 at which the additional losses were disclosed to the Board, the SEC was notified of the inaccurate financial statement. The SEC then suspended trading for 10 days. The Court of Appeal found that the market for Macrodata stock was destroyed by these events and never recovered, and that PKL, who had relied on earlier promises that its stock would be registered, was locked into its Macrodata investment. PKL sued Macrodata and Cutler-Hammer in December 1976, claiming that these events had diminished the value of PKL's Macrodata stock. [1 C.T. 1-72.]

Nearly a year later, Macrodata was merged into Cutler-Hammer pursuant to the statutory merger provisions set forth in Cal. Corp. Code § 1100 *et seq.* [*See* Ex. 1022.] At that time, Cutler-Hammer owned 72% of Macrodata stock. [*Id.*] On the advice of the investment banking firm of Morgan-Stanley, Cutler-Hammer set an exchange ratio for the merger by which Macrodata stock was valued at $4.40 per share. [Ex. 1326; 43 R.T. 7791-98.] PKL did not challenge this price, but instead waived its right under Corp. Code § 1300 *et seq.* to statutory appraisal of the value of its stock. [Ex. 272.] PKL thereupon tendered its Macrodata stock in the merger for Cutler-Hammer stock. [12 R.T. 2058-59.] At the time of the merger exchange, this Cutler-Hammer stock was worth $5.48 per Macrodata share. [43 R.T. 7803-04.]

PKL's sole damage claim at trial was that it received an unfair price in the merger. [*See* 50 R.T. 9150.] The compensatory award of $2,633,599 [12 C.T. 3909] was measured by the "shortfall" to PKL represented by the difference between the $4.40 value set for the merger and the $17.61 value set by PKL's experts. [51 R.T. 9312-24.] The Court of Appeal found that PKL's experts' opinions of value supported a jury finding that the stock was worth $17.61 per Macrodata share at the time of the merger. PKL's experts testified that their value opinions were not based on the effects of the SEC suspension or revelation of false accounting, but instead constituted their opinions of the true market value of Macrodata stock at the time of the merger. [See 26 R.T. 4519-20; 23 R.T. 4114-15; 14 R.T. 2289.]

The jury was instructed that it could award punitive damages for the wrongful conduct of either Macrodata or Cutler-Hammer [12 C.T. 3897] and awarded $15,000,000 in punitives. [12 C.T. 3909.] The Court of Appeal upheld

the trial court's ruling that Eaton was liable, as a matter of law, for any punitive damages awarded against Macrodata or Cutler-Hammer. [12 C.T. 3861; 1821.] The punitive damages award constituted 10% of Cutler-Hammer's net worth at the time of the merger [Ex. 1311 at 24; 13 R.T. 2089], and 62% of its net income [Ex. 1132 at 24]. The punitive award was 5,000 times Macrodata's 1977 net income of $3,000. [Ex. 501; 33 R.T. 5658-59.]

In 1979, subsequent to all the events at issue in the lawsuit Eaton Corporation acquired Cutler-Hammer. [*See* Ex. 1049.] Cutler-Hammer ceased to exist as a going concern. [30 R.T. 5260.] In that transaction, PKL tendered its Cutler-Hammer shares to Eaton for $1,537,258, realizing a $1.2 million profit on its original Macrodata investment. [39 R.T. 6896.][2]

B. The Proceedings

PKL filed suit against Macrodata, Cutler-Hammer and others in December 1976 (a year before the Macrodata/Cutler-Hammer merger) alleging promissory fraud and breach of a majority shareholder's duty to the minority. [1 C.T. 1-72.] PKL alleged that it had relied on false promises of registration [1 C.T. 8-13] and that Cutler-Hammer had used its power to control Macrodata to cause the destruction of the market and thereby had depressed the value of Macrodata stock. [1 C.T. 17-20.] The action was tried first in February 1982 against Macrodata, Cutler-Hammer and David Hopkins. Trial resulted in a nonsuit in favor of Hopkins [1 C.T. 335-36] and a jury verdict for compensatory damages of $2,750,000 and punitive damages of $17,500,000 against

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[2]PKL's profit on its investment was established in Eaton's offer of proof and is not mentioned by the Court in *Eaton II*.

Eaton. [2 C.T. 361.] The trial judge set aside the jury verdict against Eaton, finding both compensatory and punitive damages "clearly excessive," and granted a new trial. [1 C.T. 338-40.]

PKL appealed the nonsuit against Hopkins, but it did not appeal the new trial order. [2 C.T. 361.] The trial court refused to stay the retrial against Eaton pending the Hopkins appeal. [Supp. C.T. 5067.] The case thus went on to retrial in February 1983 while the appeal was pending. The trial court also denied Eaton's motion that the trial court lacked jurisdiction under Cal.Civ.Proc.Code § 916(a) to retry Hopkins' alleged wrongful conduct while that matter was before the appellate court by virtue of PKL's appeal [8 C.T. 2709, ¶ 4.]

In the second trial, the case went to the jury against only Macrodata and Cutler-Hammer on counts charging promissory fraud and breach of a majority shareholder's duty. After a nine month proceeding, the jury returned a general verdict that is the subject of this appeal, awarding $2,633,599 compensatory damages and $15,000,000 punitive damages against Eaton. [C.T. 3909.]

Subsequent to the jury verdict in the second trial, the appellate court (Second Appellate District, Division One) on July 5, 1984 issued its decision affirming the Hopkins' nonsuit. A copy of that unpublished opinion (*"Eaton I"*) is attached to this petition as Appendix B. The Court of Appeal found, *inter alia*, that PKL had not relied on any promises of registration (*Eaton I* at 20) and that Hopkins had not interfered with PKL's registration rights (*id.* at 22). Eaton called these rulings to the attention of the Appellate Court in this appeal and invoked the doctrines of *res judicata* and collateral estoppel. *See First N.B.S. Corp. v. Gabrielsen*, 179 Cal.App. 3d 1189, 1195, 225 Cal.Rptr. 254 (1986) (when a judgment

becomes final during the pendency of another appeal it may be brought to the attention of the Appellate Court and relied upon as *res judicata*). The Court in *Eaton II*, however, declined to give precedential effect to *Eaton I* (*see Eaton II* at 13-17) and made findings contrary to that decision. *See, e.g., Eaton II* at 4-5, 10-11, 44.

PRELIMINARY STATEMENT

This appeal raises the question of whether minority shareholders may avoid the legislature's carefully crafted statutory remedy — Court supervised appraisal — and instead ask lay juries to decide the fair value of stock in a merger. Before pursuing its jury trial, PKL with "open eyes" waived the statutory remedy (Cal. Corp. Code § 1300 et seq.) designed precisely for the purpose of affording fair and expeditious resolution of disputes over the value of stock in a merger. Yet this Court has recently ruled that appraisal is the exclusive and adequate remedy to resolve disputes over the price of stock in a merger, even where fraud and misconduct are asserted as the basis for the claim of unfair value. *Steinberg v. Amplica*, 42 Cal.3d 1198, 233 Cal.Rptr. 249 (1986). The result below was premised on a misreading of the limited exception to exclusivity set forth in Cal. Corp. Code § 1312(b): the appellate court in *Eaton II* erroneously reads the exception to permit litigation over fair value in a "common control" merger, when all that was intended was to permit equitable challenges to the merger on matters other than fair value. Absent guidance from this Court, minority shareholders will continue to pursue protracted jury trials that are not only unnecessary, but undermine the legislative purpose behind the appraisal statute.

Moreover, if such jury trials are to be permitted, guidance from this Court is necessary to establish the

ground rules, for this case illustrates that there are presently few standards upon which to have such litigation. *Eaton II* holds that juries are to resolve the equitable restrictions imposed on majority shareholders under *Jones*. The absence of precedent for that kind of proceeding is evident from the face of the trial court's instructions. While no instruction whatever was given on how to value stock in a merger (the only damages issue before the jury), the trial court, drawing largely from phrases in *Jones v. Ahmanson* which enunciated equitable principles, directed that a majority shareholder breaches its duty if it enjoys an "advantage" over the minority ("advantage" was never defined) or engages in "activities . . . that are unfair to the minority" ("unfair activities" was also never defined). [12 C.T. 3862, 3880.] The jury was further instructed that "fraud is presumed" if the majority secured an advantage. [12 C.T. 3875.] The jury was thus left free to find fraud and breach of fiduciary duty based on facts in evidence which showed *lawful* "advantages" naturally possessed by majority shareholders.

On the question of punitive damages, this case again is disturbing. The punitive award here was maximal, far higher than any prior reported decision in the California courts. It was higher not only in amount, but also in proportion; the award constituted 62% of Cutler-Hammer's net income — a ratio never before permitted under California law. Perhaps even more troubling, this punitive award was assessed against a total innocent, Eaton, which has never even been accused of any wrongdoing. In a carefully considered opinion, Judge Peckham of the Ninth Circuit District Court in *In Re Related Asbestos Cases,* 566 F.Supp. 818 (N.D. Ca. 1983) concluded that California law does not permit punitive damages to be imposed against successor corporations who, like Eaton, have no identity of interest with the predecessor corpora-

tion who engaged in wrongdoing. In reaching a contrary result, the decision of the appellate court in this case frustrates the heretofore unbroken rule that punitive damages serve no proper purpose unless imposed against the party whose conduct is to be punished.

Finally, guidance from this Court is needed where two decisions of the appellate court stand in irreconcilable conflict. This occurred because PKL was permitted to relitigate matters that were then pending before the appellate court on PKL's own appeal — a true "second bite" of the apple. Absent clarification from this Court, the problem of multiple trials and multiple appeals to resolve issues that should only be adjudicated once will continue to confront the courts.

For all of these reasons, Eaton Respectfully seeks review.[3]

LEGAL ISSUES

I.

REVIEW IS NEEDED TO SETTLE IMPORTANT QUESTIONS OF LAW CONCERNING THE IMPOSITION OF PUNITIVE DAMAGES ON INNOCENT SUCCESSOR CORPORATIONS.

Time and again the Courts have made clear that punitive damages cannot be imposed on anyone but the wrongdoer. *Ford Motor Co. v. Home Ins. Co.,* 116 Cal.App.3d 374, 380, 172 Cal.Rptr. 59 (1981); *Magallanes v. Superior Court,* 167 Cal.App.3d 878, 889-90, 213 Cal.Rptr. 547 (1985). Thus, a defendant liable for compensatory dam-

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[3]Each of the matters addressed herein was brought to the attention of the appellate court in Eaton's Petition for Rehearing (filed August 2, 1988), but the Court declined to alter its Opinion.

ages under the *Sindell* "market share" theory (without proof that its product caused any harm) cannot be liable for punitive damages (*Magallanes, supra,* 167 Cal.App.3d at 889-90); the estate of an individual who dies during trial can be assessed the individual's compensatory liabilities, but not punitive damages, because the estate is not a wrongdoer (*Evans v. Gibson,* 220 Cal.476, 489-90, 31 P.2d 389 (1934)); an employer liable in compensatory damages by respondent superior for the torts of its employee cannot be liable for punitive damages unless the employer itself acted wrongly (Civil Code § 3294(b); *Merlo v. Standard Life & Acc. Ins. Co. of Calif.,* 59 Cal.App.3d 5, 18, 130 Cal.Rptr. 416 (1976)); and a tortfeasor responsible for compensatory damages by joint and several liability is not liable for punitive damages without proof of its own malicious conduct (*Kim v. Chinn,* 56 Cal.App.2d 857, 861, 133 P.2d 677 (1943)).

Yet here, Eaton was assessed $15,000,000 in punitive damages even though it is accused of nothing. Liability was assessed on the theory that, under Cal. Corp. Code § 1107, a successor corporation is automatically liable for punitive damages imposed for the wrongdoing of a distinct predecessor. *Eaton II* at 65-66. This decision is contrary to the purpose of punitive damages, and Eaton respectfully seeks guidance from this Court on this important question.

As in all jurisdictions, a corporate successor in California is liable for the "debts and liabilities" of the predecessor. Cal. Corp. Code § 1107. In *Moe v. Transamerica Title Ins. Co.,* 21 Cal.App.3d 289, 98 Cal.Rptr. 547 (1971) this statute was interpreted to permit successor liability for punitive damages only in certain limited circumstances. *Moe* held that defendant Transamerica could be jointly liable for the punitive damages assessed against Trans-

america's predecessor, the City Title Corporation, because there was no claim that the two corporations were ever distinct: rather, "[Transamerica] made no attempt in the trial court to contend that it was a corporation separate and distinct from [City Title]." *Id.* at 303-304. In *Moe,* punitive damages were assessed against the successor because it had made "admissions that the two corporations [were] one and the same." *Id.* at 304.

The *Moe* standard was followed by Judge Peckham in *Asbestos.* In reviewing California law, Judge Peckham correctly observed that *Moe* was restrictive, permitting successor liability "only when the predecessor and successor are effectively one and the same entity." 566 F.Supp. at 823. The *Asbestos* Court held that punitive damages may thus not be imposed on successor corporations who are separate and distinct from the predecessor. *Asbestos,* carefully reviewing the substantial differences between the predecessor and successor in that case, concluded that the successor shared no identity of interest with the predecessor, and that punitive damages could thus not be imposed as a matter of law. *Id.*

Asbestos considered the various policies under California law which prohibit the imposition of punitive damages against innocent successor corporations. Punitive damages, the Court first ruled, are not part of a plaintiff's remedies. Instead, they give a windfall to a plaintiff, who receives damages which more than make him whole. Second, the Court noted that imposing punitive damages on a successor corporation could deplete the successor, and frustrate its ability to pay compensatory damages to those entitled to receive them. Third, the Court noted that imposing punitive damages on an innocent successor would change the value of the purchase the successor had made. Finally, the Court noted that the restriction under

California law against insuring for punitive damages indicated that liability for such damages cannot be shifted to an innocent party. *Id.* at 822-24.

Asbestos is on all fours with this case. Just like the two corporations in *Asbestos*, Cutler-Hammer and Eaton were always separate and distinct corporate entities. [Ex. 1049; *compare* Ex. 1131 with 1208.] There was no evidence that Eaton was a continuation of Cutler-Hammer; to the contrary, Cutler-Hammer ceased to exist. [30 R.T. 5260.] Yet the trial court ruled that Eaton was liable for punitive damages as a matter of law. [12 C.T. 1821,3861.] The appellate court here expressly declined to follow *Asbestos* (*see Eaton II* at 67) and affirmed, holding that *Moe requires* successor liability for punitive damages in all cases. *Eaton II* at 66-67. The appellate court makes no mention of the public policy prohibiting punitive damages against innocent parties.[4]

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[4] Successor liability for punitive damages has been permitted in a few other jurisdictions which permit punishment on innocent parties on the theory that wrongdoers will thereby be deterred. *See e.g.*, Iowa (*Hanlon v. Johns-Manville Sales Corp.*, 599 F.Supp 376 (N.D. Iowa (1984)), Florida (*Celotex Corp. v. Pickett*, Asbestos Litig. Reporter (Andrews Publications), p. 13,425 (Sup.Ct. Fla., May 8, 1986), and Texas (*Wall v. Owens-Corning Fiberglass Corp.*, 602 F.Supp. 252 (ND. Tex. 1985)). California has rejected the view that punitive damages may be imposed on innocent parties. *Magallanes, supra*, 167 Cal.App.3d at 889-90.

Other jurisdictions, citing *Moe*, have adopted a "continuation theory" which permits successor liability for punitive damages only where there is sufficient identity of interest between the successor and predecessor "as to justify the conclusion that those responsible for the reckless conduct of the predecessor will be punished . . ." *Brotherton v. Celotex Corp.*, 493 A.2d 1337 (N.J. Super. Law. Div. 1985); *Martin v. Johns-Manville Corp.*, 469 A.2d 655 (Pa. Super. 1983), *rev'd other grounds*, 494 A.2d 1088 (1985).

One other California case touches upon the issue. In *Marks v. Minnesota Mining & Manuf. Co.*, 187 Cal.App.3d 1429, 232 Cal.Rptr. 594 (1986), the court held that a successor corporation that was for all intents and purposes identical to the predecessor could be liable for $75,000 punitive damages imposed for conduct by the predecessor. The court noted that the successor, McGhan/Del., was essentially the same company as McGhan/Cal., the predecessor. *Id.* at 1435-36.[5] While the *Marks* Court expressed disapproval of *Asbestos,* on its facts *Marks* is consistent with *Asbestos* and in harmony with the purpose of punitive damages: to punish only wrongdoers. The imposition of such damages on Eaton could not serve that purpose. Nevertheless, the Court of Appeal herein also construed *Marks* to compel the imposition of punitive damages on Eaton. *Eaton II* at 67.

To resolve the conflict raised by the Court of Appeal's decision, and to resolve this very important question of law, this Court should grant review of the decision below. And to these reasons must be added one other. Imposing punitive damages for an unfair price in a merger will thwart the very mergers the Legislature has sought to encourage. *See* Cal.Corp.Code § 1100 *et seq; Steinberg v. Amplica*, 42 Cal.3d 1198, 233 Cal.Rptr. 249 (1986). Punitive damages undermine the legislative purpose because, in the words of Justice Powell in another context, they are "limited only by the gentle rule that they not be excessive," *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974), and cannot be forecast with any reliability. A company, trying to determine whether to merge with another, can make no reliable assessment of the value of

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[5]Defendant 3M was assessed punitive damages for the wrongdoing of its wholly owned subsidiary, (187 Cal.App.3d at 1438), an issue not pertinent here.

its potential purchase and stockholders cannot know whether their officers and directors are proceeding reasonably. Here, when Eaton bought Cutler-Hammer, no one could forecast that the price tag would be an additional $15,000,000. This very absence of standards may well render such damages unconstitutional on due process grounds. *See Banker's Life & Casualty Co., v. Crenshaw,* 56 U.S.L.W. 4418 (May 16, 1988) (Scalia, J., concurring).[6]

II.

REVIEW IS NEEDED TO MAKE CLEAR THAT PUNITIVE DAMAGES ARE UNCONSCIONABLY EXCESSIVE WHEN THEY CONSTITUTE WELL OVER HALF OF ANNUAL NET INCOME.

The Court's review also is necessary to define when a punitive damages award is excessive. Assuming punitive awards may be rendered against a successor corporation, nevertheless the award here exceeds all bounds of reason-

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[6]Three months ago in *Banker's Life and Casualty Co., v. Crenshaw, supra,* the U.S. Supreme Court noted that punitive damages awards raise important Constitutional questions which must be addressed. These issues include whether punitive damages, such as those awarded here, constitute an excessive fine, and whether they violate due process. (U.S. Const., Amend. VIII, XIV; Calif. Const. Art I, §7(a) and §17.) Until *Banker's Life,* this Court had seemed to uphold such damages. *Peterson v. Superior Court,* 31 Cal.3d 147, 181 Cal.Rptr. 784 (1982). We believe that *Banker's Life* instructs state courts of last resort to reexamine such questions, and to fully evaluate the Constitutional arguments. When the announcement of a pending appellate decision makes viable an argument which poses significant questions of law and public policy, this Court may consider the issues even if raised for the first time. *Fisher v. City of Berkeley,* 37 Cal.3d 644, 654 n.3, 209 Cal.Rptr. 682 (1984). We note that another pending Petition for Review also asks this Court to address the Constitutional issues. *April Enterprises, Inc., v. KTTV and Metromedia, Inc.,* 2nd Civil No. B 022890 (appeal pending).

ableness. The largest award ever affirmed by an appellate court (in a published opinion) is $5,000,000.[7] And the problem is a recurring one.[8] Without further definition by this Court, unconscionable imposition of punitive damages will continue.

In prior cases, this Court has ruled that a punitive damages award must be commensurate with the reprehensibility of the conduct, must bear a fair proportion to the actual damages, and must bear a fair proportion to the defendant's wealth. *Neal v. Farmers Ins. Exchange*, 21 Cal.3d 910, 928, 148 Cal.Rptr. 389, 399 (1978). While the amount of punitive damages should be sufficient to punish the wrongdoer and deter similar conduct in the future, "[b]y the same token, of course, the function of punitive damages is not served by an award which, in light of the defendant's wealth and the gravity of the particular act, exceeds the level necessary to properly punish and deter." *Id.*, 21 Cal.3d at 928.

An award which constitutes such a high percentage of a defendant's net income as here — 62% — must be determined to be the result of passion and prejudice. In *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 157 Cal.Rptr. 482 (1979), *cert. denied*, 445 U.S. 912 (1980), this Court ruled that an award which constituted 58% of a company's net worth must be considered excessive as a matter of law. *Id.* at 824. *See also Moore v. Am. United Life Ins. Co.*,

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[7]That award was recently handed down in *Downey Savings & Loan Assn. v. The Ohio Casualty Ins. Co.*, 189 Cal.App.3d 1072, 234 Cal.Rptr. 835 (1987), *cert. denied*, 108 S.Ct. 2023 (1988) (bad faith insurance case). *Downey* was authored by the Honorable Joyce L. Kennard, who also participated in *Eaton II*.

[8]Eaton is advised that a $14,000,000 punitive award was upheld in an unreported decision in *April Enterprises, Inc., v. KTTV*, B 022890, in which a Petition for Review has also been filed seeking guidance on the excessiveness of punitive damages.

150 Cal.App.3d 610, 641, 197 Cal.Rptr. 878 (1984) (punitive damage measured by net income test); *Pistorius v. Prudential Ins. Co.,* 123 Cal.App.3d 541, 555, 176 Cal.Rptr. 660 (1981) (same); *Roemer v. Retail Credit Co.,* 44 Cal.App.3d 926, 937, 119 Cal.Rptr. 82 (1975) (same). The Court of Appeal here disregarded *Egan,* and ruled that it was not required to consider net income. *Eaton II* at 69.[9]

There are good reasons to measure punitive damages by their effect on net income. While the worth of a company is important for the company's long-term potential, the income of a company enables it to function on a daily basis. Taking such substantial portions of a defendant's net income, as was done here, can be crippling. It can cause substantial layoffs and sharply hinder supply of products or services — effects which go beyond punishment and deterrence.[10]

The Court of Appeal's opinion not only overlooks *Egan* and the proportion of net income, but also upholds an award which exceeds all other awards when *both* net income and net worth are considered together. *See Burnett v. National Enquirer, Inc.,* 144 Cal.App.3d 991, 193

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[9]While the trial court instructed that misconduct be *either* Macrodata or Cutler-Hammer was a proper basis for punitive damages [12 C.T. 3897], the court refused Eaton's request to instruct that any punitive damages assessed for Macrodata's misconduct must be measured against that defendant's wealth. [53 R.T. 9627:5-26:6.] If the jury awarded punitive damages against Macrodata, the award constitues 500,000% of that company's 1977 net income of $3,000. [Ex. 501; 33 R.T. 5658-59.]

[10]There could be no justification, of course, for measuring the award against *Eaton's* wealth, since there is no claim that Eaton should be punished for wrongdoing. The trial court so ruled [12 R.T. 1821-22] and the appellate court did not disturb this ruling.

Cal.Rptr. 206 (1983) (5.8% net worth, 9.62% net income); *Moore, supra* (3.2% net assets, 6.5% net income)); *Roemer v. Retail Credit Co., supra* (.63% net worth, 2.78% net income); *Neal v. Farmers Ins. Exch., supra* (.35% net assets, 2% net income). Simply put, this case establishes a new and far-reaching extension of the permissive level of punitive damages.

Finally, even accepting that the facts as found by the Court of Appeal constitute sanctionable conduct, the award still must be deemed excessive to accomplish the purposes of punitive damages. Cutler-Hammer's undisputed financial support for Macrodata during a period where that company almost went bankrupt [*see* 13 R.T. 2143-45; 47 R.T. 8489-91] produced a $1.2 million *profit* for PKL. [39 R.T. 6896.] In the face of far more eggregious conduct, the courts have striken far less substantial awards. *See, e.g., Burnett, supra* (punitive award of $1.3 million, based on utterly reprehensible libel of public figure in a national magazine, reduced to $150,000 by appellate court).

In allowing such excessive punitive damages, the decision here thus conflicts with the decisions of several Courts of Appeal and of this Court. This Court's guidance is needed to make clear that net income must be considered, and to maintain a boundary on the permissable amount of punitive damages.

[The remainder of Eaton's Petition for Review is omitted.]

APPENDIX H

List of Non-Wholly Owned Subsidiaries and Affiliates of Petitioner

1. Asiaphil Manufacturing Industries, Inc. (Philippines)
2. Axles India, Limited (India)
3. Cutler-Hammer, Mexicana, S.A. (Mexico)
4. Cutler-Hammer, Nigeria Limited (Nigeria)
5. Delta Holdings, Inc.
6. Eaton Controles Industriales, S.A. (Costa Rica)
7. Eaton Manufacturera S.A. de CV (Mexico)
8. Eaton S.A. (Spain)
9. Eaton Valeo Clutch Corporation
10. Ejecol Sociedad Anonima (Colombia)
11. Ejeven S.A. (Venezuela)
12. Engineered Sintered Components, Inc.
13. Ghisalba, S.p.A (Italy)
14. Hobourn-Eaton Steering Limited (U.K.)
15. Japan Fawick Company Limited (Japan)
16. Modern Molded Products, Limited (Taiwan)
17. Nittan Valve Co. Ltd. (Japan)
18. Plasto S.A. (France)
19. Productos Eaton, Livia S.A. (Spain)
20. Sammi-Eaton Axles Co. Ltd. (S. Korea) (eff. 2/88)
21. Sumiju Eaton, Soko Systems Company Limited (Japan)
22. Sumitomo Eaton Hydraulics Co. Ltd (Japan)
23. Sumitomo Eaton Nova Corp. (Japan)
24. The Electron Corporation (USA)
25. The Electron Corporation
26. U.S. Engine Valve Corporation

PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On February 10, 1989, I served the within Petition for Writ of Certiorari in re: "Eaton Corporation v. The PKL Companies, Inc." in the United States Supreme Court, October Term 1988, No.....

On the PKL Companies, Inc. and the Attorney General of the State of California, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

Stephen A. Kroft, Esq.
Rosenfeld, Meyer & Susman
9601 Wilshire Boulevard
Fourth Floor
Beverly Hills, California 90210

Office of the Attorney General
3580 Wilshire Boulevard, Suite 600
Los Angeles, California 90010
Attention: Barbra Crudupt, Legal Analyst

All Parties required to be served have been served.

I certify under penalty of perjury, that the foregoing is true and correct.

Executed on February 10, 1989, at Los Angeles, California

J. GORDON HOOPER